

LANXESS LXS.GR

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			2017	2018
Price:	68.00	EPS	0	0
Shares Out. (in M):	91	P/E	0	0
Market Cap (in \$M):	6,200	P/FCF	0	0
Net Debt (in \$M):	2,400	EBIT	0	0
TEV (\$):	8,600	TEV/EBIT	0	0

Description

Lanxess AG (LXS.AG)

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Summary

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We focus on smaller companies with Ft. Knox balance sheets and large & sustainable free cash flow yields and we are typically seeking a double-digit FCF yield or higher on an unleveraged basis. The objective is for the sustainable FCF to eventually drive up the share price to a more reasonable valuation through share buybacks, debt reductions, dividends, or accretive acquisitions. Obviously, it is important we have a management team that cares about shareholder value. We generally focus on small and micro-cap stocks because there is a much better chance to find an attractive investment opportunity which is under-followed or undiscovered.

A larger cap stock we have owned for the past 18 months is Lanxess AG (LXS.AG) a specialty chemical company based in Germany. The Company was spun off from Bayer AG in 2004. Under prior management, Lanxess over-expanded into its specialty rubber business segment and borrowed heavily to fund it. Lanxess was hit hard by global capacity over-expansion and an over-leveraged balance sheet when oil prices declined sharply. EBITDA pre-items dropped steeply in 2013. Matthais Zachert became CEO in April 2014 after being CFO of Bayer AG from 2011 to 2014. Zachert was previously CFO of Lanxess from 2004 to 2011 which was a very successful period for the Company. Since returning, he has completely transformed Lanxess and its strategy. Since Zachert's return, Lanxess reduced exposure to its competitive, commodity-oriented specialty rubber segment, strengthened its balance sheet to investment grade, and strongly grown its high-margin, cash-generative specialty chemical segments. We initially invested in Lanxess at about 45 euros per share and have added since. While Lanxess shares have since moved up considerably to about 68 euros, we believe there is significant potential value that remains.

To appreciate the executive talents of Matthais Zachert, consider that the day he announced he was leaving Merck AG as CFO, its stock dropped about 12% and concurrently Lanxess stock rose about 10%. From a Financial Times article in August 2014: "Mr. Zachert knows Lanxess the way most parents know their children. As chief financial officer, he helped the chemical company find its feet after it was formed in 2004, when Bayer spun off a bunch of unwanted, low-margin assets. Lanxess expanded its production footprint beyond high-cost Germany, overhauled its portfolio and refocused on high-tech plastics, rubbers, and specialty chemicals. Adjusted earnings before interest, taxation, depreciation and amortization rose by an annual average of 20 per cent between 2004-12".

As we have watched Zachert over the past 18 months, we conclude that while Lanxess stock has appreciated significantly, it could go a lot higher, especially in Zachert's capable hands. Zachert is focused on building a specialty chemical powerhouse by 2020 and based on what we have seen so far, we would not bet against him. The combination of a good business (specialty chemicals) and an excellent management team skilled at both organic and inorganic growth, can be a powerful combination. Lanxess could present such an opportunity.

In 2014, Zachert implemented his realignment program "Let's Lanxess Again" to make Lanxess a specialty chemicals group with enhanced stability,

improved cash flow, more resilience, and a more balanced portfolio. To achieve this objective, Lanxess focused on less competitive mid-sized chemical markets. The realignment program included Phase 1 of 150m euros of cost reductions in administrative and overhead expenses which were achieved ahead of schedule. Phase 2 includes a further 150m euros in cost reductions and efficiencies at manufacturing plants and supply chain saving and is targeted for completion by 2019. The realignment program also included a shift in strategic portfolio positioning towards the higher margin, cash-generative specialty chemical businesses which are focused on mid-size markets. This effort took a major step forward with the Arlanxeo transaction in April 2016 wherein Lanxess sold 50% of its commodity-oriented specialty rubber business to Saudi Aramco for 1.2b euros. The Arlanxeo transaction enabled Lanxess to significantly reduce net debt from 1.7b euros at year-end 2013 to about 280m euros at year-end 2016. Lanxess currently has an investment grade rating and maintaining this rating is part of the strategic plan.

Saudi Aramco is the largest producer of crude oil in the world, which is the primary input into the specialty rubber business. The JV is called Arlanxeo and is debt-free and managed by Lanxess. Previously, Lanxess' specialty rubber business was the only producer without an integrated source of raw materials. Over the long-term, Arlanxeo should benefit from its strategic supply relationship with Saudi Aramco but these benefits will not be realized until 2019 or 2020 as current supply contracts expire. Arlanxeo's strong balance sheet positions it well to work through the current "trough environment" in the specialty rubber industry as excess capacities and inventories are rationalized, and there is starting to be some evidence of rationalization. Arlanxeo could also benefit from consolidation in the specialty rubber industry and Saudi Aramco is clearly focused on forward integrating into higher value added segments.

Lanxess remaining specialty chemical segments (non-Arlanxeo) are called "New Lanxess" and these are strong, resilient businesses which are less capital intensive and more cash generative. Lanxess is focused on expanding these segments both organically and inorganically. Lanxess' stronger balance sheet has enabled it to focus on growing in these stronger specialty chemical mid-size markets. Chemours' Clean and Disinfect business was acquired in August 2016 for about 210m euros which added 100m euros of revenues and 20m euros of LTM adjusted EBITDA with 10m euros of synergies expected by 2020. In September 2016, Lanxess announced the proposed acquisition of Chemtura in the U.S. for about 2.4b euros. The Chemtura acquisition closed on April 21, 2017. Chemtura Corp. is one of the major global providers of flame retardant and lubricant additives, which builds significantly on Lanxess own additives portfolio. Lanxess is now one of the world's major players in this market. Chemtura adds about 1.5b euros of revenues and 250m euros of LTM EBITDA pre with expected synergies of about 100m euros by 2020. Chemtura will also further expand Lanxess footprint into faster-growing North America and Asia Pacific markets and further diversify Lanxess' end market customer industries.

Valuation and Price Target

We believe Lanxess can significantly grow EBITDA pre in 2017 and 2018 in its "New Lanxess" segments with Chemtura and its synergies layered on top. Under Zachert, Lanxess has grown EBITDA pre from 735m euros in 2013 to 808m euros in 2014 (10% growth) to 885m euros in 2015 (9.5% growth) to 995m euros in 2016 (12% growth). We believe Lanxess can grow EBITDA pre by about 10% per year in 2017 and 2018 to about 1.1b euros and 1.2b euros, respectively. We believe Chemtura could add about 300m euros in 2018, its first full year under Lanxess ownership. This would result in EBITDA pre of about 1.5b euros in 2018. We would subtract 200m euros for the 50% of Arlanxeo owned by Saudi Aramco, resulting in EBITDA pre of about 1.3b euros in 2018.

Lanxess' enterprise value (EV) post Chemtura is 8.6b euros based on a share price of about 68 euros per share price. Lanxess has most recently guided to 1.23b to 1.3b euros of EBITDA pre for 2017, which includes Chemtura since April 21, 2017, or about 8 months. Pro forma for a full year of Chemtura (about 60m euros of EBITDA per quarter), we believe Lanxess EBITDA pre for 2017 would be close to 1.38b euros (Lanxess results are trending towards the high end of guidance for 2017). In 2018, we expect synergies from Chemtura and continued margin improvement from New Lanxess segments and we believe Lanxess could achieve EBITDA pre of 1.5b euros consolidated or 1.3b euros excluding 50% of Arlanxeo JV. Based on this, Lanxess is trading at about 6.6x our 2018 EBITDA pre (ex 50% of Arlanxeo JV) of 1.3b euros.

We believe Lanxess specialty chemical businesses could eventually be valued at 9x EBITDA pre for 2018 or about 11.7b euros. We believe by year end 2018, Lanxess could reduce net debt to about 1.7b euros for a market cap of about 10b euros or about 110 euros per share, about 65%

higher than the current share price.

We believe the specialty chemical industry is an important part of the global economy. Specialty chemicals are critical to many areas of our everyday life, including water purification, painting coating and coloring, leather treatment, automotive parts, insect repellants, and numerous other areas. There has also been significant consolidation and M&A in the specialty chemical industry in recent times.

Berkshire Hathaway

In late May 2017, one of Berkshire Hathaway's insurance units bought a 3% stake in Lanxess, making it one of the six largest shareholders. Berkshire purchased Lubrizol, a similar specialty chemical company, for about \$9b in 2011, and we believe Berkshire has been happy with this acquisition. We believe Lanxess is exactly the kind of cash-generative, stable business with an outstanding management team that Berkshire would like to acquire. We are not sure about regulatory or political issues but would not be surprised if Berkshire or another strategic type player sought to acquire Lanxess.

Segments

Advanced Intermediates includes two business units, Advanced Industrial Intermediates and Saltigo, which make it one of the world's leading suppliers of industrial chemical intermediates and a key player in the custom synthesis and manufacturing of chemical precursors and specialty active ingredients. Applications include Agrochemicals, Automotive, Construction, Aromas and flavors, Pharmaceuticals, and Tire Chemicals. Advanced Industrial Intermediates is an important supplier of high quality industrial chemicals, including Aromatic compounds, Amines, Antidegrants, Accelerators, and Peptizing Agents, among others. Saltigo includes development and production of numerous products used as raw materials as well as intermediate products for crop protection agents and pharmaceutical active ingredients, and other high quality fine chemicals.

Performance Chemicals includes five business units, Rhein Chemie Additives, Inorganic Pigments, Material Protection Products, Leather, and Liquid Purification Technologies. This includes Lanxess' application oriented process and functional chemicals operations. Applications include polymer additives, disinfection, protection and preservation of wood, coatings and foodstuffs, color pigments, and products for leather processing and water treatment.

High Performance Materials (HPM) includes Lanxess' engineering plastics activities. Applications include Automotive, Construction, and Electrical / Electronics and medical equipment. HPM is transforming into a global player in engineering plastics and has 600 customers primarily in the automotive and electric & engineering industries. It focuses on key materials for the auto industry including lightweight technologies, interior and exterior products, alternative powertrains, etc. There is a major focus by auto manufacturers on reducing weight in newer model cars and Lanxess is a key player in increasing the proportion of plastic in new model autos to reduce weight and improve fuel efficiency. HPM acts as a development partner with lightweight and ultra-lightweight structures. HPM also focuses on the Electrical & Electronic industry, including LED & lighting, consumer electronics, and household appliances. HPM also acts as development partner for the E&E industry, based on ecological features, safety & reliability, including a wide range of flame retardant gauges, and new concepts for LED lighting. Engineering plastics enable lightweight solutions for both auto and E&E industries.

Arlanxeo includes two business units, Tire & Specialty Rubbers and High Performance Elastomers, which encompasses all of Lanxess' synthetic rubber activities. Applications include Tires, Automotive, and Electrical / Electronics and medical equipment.

Sales by Segment	2015	2016
Advanced Intermediates	1,826	1,742
Performance		

Chemicals	2,085	2,142
High Performance Materials	1,085	1,056
Arlanxeo	2,859	2,710
Reconciliation	47	49
Total	7,902	7,699

EBITDA pre exceptionals by Segment	2015	2016
Advanced Intermediates	339	326
Performance Chemicals	326	374
High Performance Materials	111	159
Arlanxeo	391	373
Reconciliation	(282)	(237)
Total	885	995

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Chemtura is An Attractive Acquisition

With Chemtura, Lanxess is one of the largest players in the world in chemical additives, along with industry leader, Lubrizol. Lubrizol was acquired by Berkshire Hathaway in 2011 for about \$9b. Lanxess will be a major player in flame retardant specialty chemicals, which is an attractive and growing area of the specialty chemical industry. Chemtura is an attractive fit for Lanxess, which already had significant operations in both additives and flame retardant chemicals prior to the acquisition of Chemtura. As a result, Lanxess expects significant synergies as part of the Chemtura acquisition of about 100m euros by 2020.

Lanxess believes additives are among the most attractive product groups in the specialty chemical industry due to high demand for technical service and strong product enhancement relative to share of customer's costs. Additives attractive characteristics include: 1) small part of customer's costs; 2) desired results are important to customers; 3) knowledge and technical service intensive; and 4) low capital intensity business. Almost 80% of Chemtura's revenues are from lubricant additives and flame retardant additives business segments. Chemtura has about 2,500 employees at 20 plants in 11 countries. Chemtura also has key customer bases in growing industries such as Building and Construction; Electrical & Electronics; Energy; and Transportation. Chemtura also diversifies Lanxess global revenue exposure, with North America about 40% of total revenues and Asia about 30% of total revenues, and thus gives Lanxess more exposure to higher growth markets in North America and Asia. Chemtura's additives business is stronger in the U.S. market while Lanxess additives business is stronger in Europe, so the two companies fit together nicely.

Lanxess sold three debt offerings to for about 1.5b euros total to fund the Chemtura acquisition. These debt offerings have investment grade ratings and an average interest rate of below 2% which makes the addition of 250m to 350m of adjusted EBITDA from Chemtura very accretive.

With Chemtura, Lanxess will have a more diversified and balanced portfolio of four strong business units, including Advanced Intermediates (2b euros of sales); Performance Additives (2b euros); High Performance Materials (1.5b euros); and Performance Chemicals (1.5b euros). Lanxess will also own 50% of Arlanxeo with Saudi Aramco as its JV partner. Lanxess end market exposure will be further diversified after Chemtura, into

automotive, chemicals, agrochemicals, consumer. Construction, electrical and engineering, general industrials, and other.

Sales Organization and Customers and Sales by Market

Lanxess sells to several thousand customers in more than 150 countries around the world. Each business unit manages its own sales in order to keep as close as possible to customers. One competitive advantage results from having 50 of its own production sites in 17 countries which allows customers to be supplied from sites in the same region. Selling costs for 2013, 2014, and 2015 were 755m euros, 742m euros, and 759 euros, respectively. Selling costs represented 9.1%, 9.3%, and 9.6% of sales, respectively, for 2013, 2014, and 2015.

Lanxess has a large number of customers around the world, who require an individualized, well-focused approach, which Lanxess is able to provide because its sales organizations are managed through the business units. Lanxess regularly reviews sales and marketing strategies on the basis of customer satisfaction surveys.

Lanxess major industry sectors served in 2016 were as follows: Tires - 20% of sales; Automotive – 20% of sales; Chemicals – 15% of sales; Agrochemicals – 10% of sales; Construction, electrical/electronics, leather/footwear – 15% of sales; and Other – 20% of sales.

These percentages include 100% of Arlanxeo and do not include Chemtura. The Chemtura acquisition significantly further diversifies Lanxess' major industry sector exposure among these key segments.

Sales by Market	2015	2016
EMEA (excluding Germany)	2,235	2,254
Germany	1,365	1,292
North America	1,368	1,326
Latin America	830	788
Asia Pacific	2,014	2,039
Total	7,902	7,699

Seasonality

The Company's seasonality is shown below, which shows quarterly revenues and adjusted EBITDA, and indicates that Q4 is typically the weakest quarter.

Strong Market Positions in Attractive Specialty Chemical Segments

We believe the specialty chemical industry has attractive characteristics over the long-term and Lanxess has strong market shares in some of the most attractive segments of the specialty chemical industry. These are higher valued added markets which are less competitive and less commodity-oriented. Lanxess is moving further into mid-sized and niche markets and increasing the degree of specialization which is driven by technology and services. These higher value-added businesses help strengthen its overall business model. The Company is focused on expanding these stronger specialty chemical segments through add-on acquisitions which are adjacent to existing segments and have high synergies and which improve its competitive positioning. The acquisitions of Chemours' Clean and Disinfect businesses and Chemtura are examples of Lanxess' strategy to make strategic acquisitions to expand its market position in stronger specialty chemical segments. Lubrizol, a specialty chemical company similar to the lubricants business segment is owned by Berkshire Hathaway. Berkshire purchased Lubrizol for about an EV of about \$9b in 2011 for about 1.6x revenues and 7x adjusted EBITDA.

Solid growth in EBITDA pre in 2016 and Good Growth Prospects for 2017 and 2018

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Lanxess is focused on continued growth in EBITDA pre-items in 2017 and 2018. Lanxess has achieved over 10% per annum growth in EBITDA pre since Zachert took over as CEO in March 2014. Lanxess grew volume in all segments in 2016 and this is a better indicator of market share progress, given volatile raw material prices which are primarily passed through to end customers. We believe Lanxess can continue to grow volumes and EBITDA pre in its specialty chemical segments in 2017 and 2018. We believe Lanxess can grow adjusted EBITDA pre-items at about 10% per annum in 2017 and 2018. EBITDA pre grew from 555m euros for 6 mos. 2016 to 695m euros for 6 mos. 2017 or about 25%, including 2 mos. of Chemtura in 2017. We believe Lanxess can grow EBITDA pre at least 10% over 2016, with Chemtura results layered on top.

Excellent Management Team

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We believe Matthais Zachert is a strong CEO with an excellent track record. We believe he is very adept at cost-cutting, rationalizing operations, and exiting weaker businesses and growing stronger businesses both organically and through acquisitions. He has a very sharp pencil in terms of evaluating both capital expenditures and working capital investments. He is highly focused on converting Lanxess into a more resilient, stable, and cash-generative company by 2020 and we believe he is well on his way. He was CFO of Lanxess from its IPO in 2004 when share price increased from 18 euros per share to close to 60 euros per share when he left to become CFO of Merck AG. Lanxess shares jumped 10% on the day he was announced as CEO in January 2014 while Merck AG shares fell about 12%. We believe he has an excellent game plan to drive long-term shareholder value and the focus to execute on it effectively.

Strong Cash Generative Business Model

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Lanxess has a highly cash-generative business model with a solid return on invested capital (ROIC). Lanxess has consistently generated strong cash from operations year after year. Cash from operations should be increased significantly with the Chemtura acquisition. Lanxess has consistently converted a high percentage of EBITDA into cash from operations and we would expect this to continue. Over the past six years, cumulative cash from operations was about 4.5b euros or over 65% of Lanxess' enterprise value (EV) before Chemtura. In 2016, Lanxess generated close to 700m euros of cash from operations with about 450m euros of capital expenditures, which we believe includes significant growth expenditures.

We believe the Company has excellent prospects for growth in revenues, EBITDA pre and FCF. We believe Lanxess will achieve the projected synergies for Chemtura and will further improve margins on its existing specialty chemical business segments. Management is highly incentivized to earn strong returns on capital (ROCE) and to convert a large portion of EBITDA pre into cash flow. Lanxess is targeting at least 60% cash conversion by 2020, defined as the ratio of EBITDA pre less capital expenditures to EBITDA pre. Zachert is focused to driving growth in EBITDA pre but only in a non-capital intensive manner with good returns on ROIC. Business segments that cannot become market leaders and grow EBITDA pre and maintain a high ROIC will be candidates for disposition.

Focus on Resilient Business Model

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While Lanxess results declined in 2009 during the Great Recession, they rebounded strongly and quickly in 2010. Further, Lanxess business model is stronger today than in 2009. Zachert is focused on building resiliency into Lanxess' business model, targeting reduced volatility of 2-3% of adjusted EBITDA margin from peak to trough periods. While the Company's business model is not recession-proof, we do believe it is recession-resistant, given the critical inputs as part of everyday products which its specialty chemical products represent, even in a recession. Lanxess current business model is less exposed to volatile, commodity-oriented segments than in 2009.

Ability to Pass Through Volatile Raw Material Prices to End Customers

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A large part of Lanxess cost structure are raw material inputs and Lanxess has shown a strong ability to pass through changes in raw material

prices to its end customers, even in quite volatile price environments, like in 2016. We believe this speaks to the strength of the business model and customer relationships and value-add for the end customers. Sometimes there is a months or quarter lag in putting through price increases but thus far Lanxess has dealt with price changes very effectively, with minimal pressure on its margins. As oil prices have moved up recently, Lanxess has shown it can pass through these price changes to end customers with very modest impact on its profit margins.

Strongly Improved Profitability and Debt Reduction in Past Three Years

CEO Matthais Zachert returned to Lanxess in April 2014 and under his "Let's Lanxess Again" realignment plan adjusted EBITDA margins have increased significantly and net financial debt has been reduced from 1.7b euros to about 280m euros at year end 2016. After the acquisition of Chemtura in April 2017, net debt is about 2.4b euros. Lanxess Phase One realignment program reduced administrative expenses by over 150m euros p.a. and Phase Two targets another 150m p.a. of savings from manufacturing plant and supply efficiencies by 2019. Lanxess also has targeted investments in total of about 400m euros through 2020 to drive organic growth through carefully targeted capital expenditures such as debottlenecking, adding production lines, etc. to increase the capabilities and efficiencies of the existing manufacturing plant network. EBITDA pre since Zachert arrived in early 2014 has gone from 735m euros in 2013 to 995m euros in 2016 and we believe further growth is possible.

Opportunity for Higher Multiple as Business Model Shifts

We believe Lanxess may gradually be recognized with a higher multiple of adjusted EBITDA if it can continue to execute with existing "New Lanxess" specialty chemical segments and move into stronger, higher value added, more resilient specialty chemical segments via selected organic investments and inorganic acquisitions such as Chemours Clean and Disinfect business and Chemtura. We do not believe a multiple of 9x EBITDA pre is unreasonable given where some other specialty chemical companies trade and the valuations of some acquisitions in the industry as well as current low interest rates. We believe Lanxess' 50% ownership of Arlanxeo specialty rubber segment will contribute only about 15% of consolidated EBITDA pre in 2018.

Attractive Upside Potential

In 2016, Lanxess generated EBITDA pre-items of about 995m euros and cash from operations of about 687m euros. We believe Lanxess can grow revenues and EBITDA in 2017 and 2018, including Chemtura, based on modest growth in revenues and improved adjusted EBITDA margins as various margin enhancement programs initiated by management continue to take hold. We believe Lanxess' specialty chemicals business segments are more resilient, cash generative, and higher margin than the current valuation is giving Lanxess credit for.

We believe Lanxess could achieve consolidated EBITDA pre in 2018 of about 1.3b euros (ex 50% of Arlanxeo JV) with about 1.7b net debt at year-end 2018. We believe Lanxess could trade for an enterprise value of about 11.7b euros or 9x adjusted EBITDA in 2018 with 1.7b euros net debt and about 91m total common shares outstanding or a share price of about 110 euros per share (about 60% higher than current prices).

Solid Balance Sheet Enables Value Creation

Even after the Chemtura acquisition, Lanxess continues to have a solid, investment-grade balance sheet with a net debt of about 2.4b euros or about 2x net debt to pro forma adjusted EBITDA. While we typically do not like any debt in our investments, Lanxess has a stable group of specialty chemical businesses that we believe can generate strong cash flows to rapidly pay down debt, even in a weak economic climate. Lanxess debt is rated investment grade and management is very focused on maintaining this rating. Lanxess raised 1.5b euros for the Chemtura acquisition at an average interest rate below 2% and its debt offerings were highly over-subscribed. We believe management has positioned Lanxess to generate substantial free cash flow post-Chemtura which will be used to reduce net debt in 2017 and 2018. We believe net debt could be reduced to 1.7b euros by year end 2018.

Conclusion and Target Price

Based on 9x our estimated EBITDA of 1.3b euros for 2018 (ex 50% of Arlanxeo) with net debt of about 1.7b euros outstanding at year-end 2018, we believe Lanxess could trade for an EV of close to 11.7b euros or a market cap of about 10b euros. Based on 91m shares outstanding today, this would imply a share price of about 110 euros or 60% higher than today's price of about 68 euros. If Lanxess continues to execute and its specialty chemical segments perform as we expect, we think our target price can be achieved.

Major shareholders		
BlackRock Institutional	5,161	5.6%
Norges Bank	4,303	4.7%
Templeton	2,779	3.0%
Berkshire Hathaway	2,775	3.0%
Allianz	2,766	3.0%
TIAA	2,765	3.0%
Dimensional	2,748	3.0%
Union Investment	2,747	3.0%

		Avg Daily Volume
Price per share	68 euros	807,000
Shares outstanding	91m	
Market value	6.2b	
52-week range	34 euros	

Income statements									
FYE 12/31	2010	2011	2012	2013	2014	2015	2016	1H16	1H17
Sales	7,120	8,775	9,094	8,300	8,006	7,902	7,699	3,863	4,923
Gross profit	1,739	2,010	2,108	1,548	1,588	1,748	1,754	938	1,112
SG&A expenses									
Adjusted EBITDA pre-items	918	1,146	1,223	735	808	885	995	555	695
Adjusted EBIT pre-items	635	826	847	288	402	422	514	320	419
Net income	379	506	508	(159)	47	165	192	136	117
EPS - continuing ops	4.56	6.08	6.11	(1.91)	0.53	1.80	2.69	1.40	0.89
Cash flow statements									
FYE 12/31	2010	2011	2012	2013	2014	2015	2016	1H16	1H17
Net income before tax	493	655	660	(239)	80	288	339	241	223
Dep & Amort.	283	325	378	717	426	418	481	235	289
Non-cash adjust	67	89	112	109	72	14	(128)	(28)	(95)
Working capital changes	(413)	(397)	(312)	54	219	(38)	(5)	(220)	(251)
Cash from operations	430	672	838	641	797	692	689	228	166
Capital expenditures **	(501)	(679)	(696)	(624)	(614)	(434)	(439)	(122)	(162)
Dividends	(42)	(58)	(72)	(83)	(46)	(46)	(55)	(55)	(67)
Share repurchases	0	0	0	0	0	0	0	0	0
Acquis, net	0	(285)	0	0	0	45	(198)	0	(1,782)
Est. free cash flow									
Balance sheets									
FYE 12/31	2010	2011	2012	2013	2014	2015	2016	1H16	1H17
Cash	524	528	797	533	518	466	395	1,363	759
Total assets	5,666	6,878	7,519	6,878	7,250	7,219	9,877	8,300	10,912
Total debt	1,476	2,100	2,334	2,317	1,880	1,701	2,812	1,666	3,326
Pension obligations and other	605	679	893	943	1,290	1,215	1,249	1,424	1,416
Shareholder equity	1,761	2,074	2,330	1,900	2,161	2,323	3,728	3,435	3,579
Net debt (1)	952	1,572	1,537	1,784	1,336	1,211	269	(105)	2,537
Adjusted EBITDA %	12.9%	13.1%	13.5%	8.9%	10.1%	11.2%	12.9%	14.4%	14.1%
Gross Margin %	24.4%	22.9%	23.2%	18.7%	19.8%	22.1%	22.7%	24.3%	22.6%
Shares outstanding		83.3	83.3	83.3	91.2	91.2	91.2	91.5	91.5

(1) Net debt excludes pension obligations which are shown separately.

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EBITDA Pre Exceptionals by Segment

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	
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Advanced Intermediates	286	308	339	326	
Performance Chemicals	231	269	326	374	
Performance Polymers	389	392	502	159	
High Performance Materials					
Aralanxeo				373	
Reconciliation	(171)	(161)	(282)	(237)	
Total	735	808	885	995	

1. Performance Polymers was divided into High Performance Materials and ARLANXEO in 2016.

Revenues by Region

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	
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EMEA (excluding Germany)	2,404	2,296	2,325	2,254	
Germany	1,458	1,440	1,365	1,292	
North America	1,332	1,338	1,368	1,326	
Latin America	966	859	831	788	
Asia Pacific	2,140	2,073	2,014	2,039	
Total	8,300	8,006	7,902	7,699	

Seasonality

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
-				
2017 – Total revenues	2,401	2,522		
2017- Adjusted EBITDA pre	328	367		
2016 – Total revenues	1,920	1,943	1,921	1,915
2016- Adjusted EBITDA pre	262	293	257	183
2015- Total revenues	2,038	2,105	1,953	1,806
2015 – Adjusted EBITDA pre	229	270	235	151
2014 – Total revenues	2,043	2,019	2,404	1,904
2014 – Adjusted EBITDA pre	205	239	210	154

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	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17
Current Assets:												
Cash and equivalents	275	518	344	432	320	466	333	1,363	1,210	395	494	759
Accounts Receivable	1,155	1,015	1,213	1,183	1,061	956	1,082	1,112	956	1,088	1,338	1,389
Inventories	1,527	1,384	1,414	1,411	1,415	1,349	1,339	1,332	1,395	1,429	1,494	1,733
Other current assets						730				2,446	2,389	473
Total current assets	1,622	3,149	3,330	3,313	3,201	3,039	3,034	4,095	3,842	5,358	5,715	4,354
Property and equipment, net	3,139	3,333	3,468	3,359	3,275	3,447	3,330	3,345	3,339	3,519	3,456	4,100
Goodwill												
Other assets												
Total Assets	7,360	7,250	7,678	7,422	7,217	7,219	7,140	8,300	8,242	9,877	10,202	10,912
Current Liability												
Accounts payable	688	799	833	829	719	779	702	683	727	889	927	933
Accrued expenses	430		424		440	443	484	408	467	78	135	592
Total current liabilities	1,622	1,642	1,836	1,631	1,579	1,960	1,779	1,733	1,571	1,633	1,800	2,313
Other financial liabilities	1,780	1,698	1,731	1,719	1,671	1,258	1,258	1,258	1,256	2,734	2,733	2,734
Pension & post emp. provisions	1,142	1,290	1,535	1,292	1,301	1,215	1,375	1,424	1,479	1,249	1,300	1,416
Deferred income taxes												
Other liabilities												
Total Stockholder's equity	2,364	2,161	2,065	2,288	2,188	2,323	2,294	3,435	3,453	3,728	3,816	3,579
Net debt (1)	1,505	1,180	1,387	1,287	1,351	792	925	(105)	46	269	298	2,537

1. Net debt excludes pension liabilities which are shown separately.

Quarterly Income Statements

	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17
Revenue	2,043	2,019	2,040	1,904	2,038	2,105	1,953	1,806	1,920	1,943	1,921	1,915	2,401	2,522
Gross profit	417	440	401	330	443	485	455	365	461	477	446	370	546	566
Selling expenses	186	188	186	182	183	200	190	186	194	191	192		218	238
R&D expenses	45	40	39	36	32	34	32	32	30	32	34		34	38
General administrative expenses	74	71	62	71	64	68	70	82	72	73	67		72	95

Other operating income	(31)	(34)	(30)	(23)	(23)	(71)	(34)	(79)	(44)	(36)	(25)		(29)	(58)
Other operating expense	68	53	61	126	124	77	93	73	78	41	56		59	191
Income from operations	75	122	83	(62)	63	177	104	71	131	176	122		192	62
Income before taxes	38	94	55	(107)	34	144	68	42	94	147	100		162	61
Net income	24	54	35	(69)	21	87	41	18	53	83	60		103	14
Adj. EBITDA pre	205	239	210	154	229	270	235	151	262	293	257	183	328	367
Gross margin %	20.4	21.8	19.7	17.3	21.7	23.0	23.3	20.2	24.0	24.6	23.2	19.3	22.7	22.4
Adj EBITDA pre %	10.0	11.8	10.3	8.1	11.2	12.8	12.0	8.4	13.7	15.1	13.4	9.6	13.7	14.6

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	Lanxess AG (LXS)	Cabot Corp (CBT)	W.R. Grace & Co. (GRA)
	Develops, manufactures, and markets specialty chemicals worldwide. Operates in three segments, Performance Polymers, Advanced Intermediates and Performance Chemicals, with 50% ownership in Arlanxeo JV for specialty rubbers.	Operates as specialty chemicals and performance materials company. Company offers carbon black, used to enhance properties of its applications, and specialty grades of carbon black used in inks, coatings, toners, etc. Sells products primarily through distributors.	Produces and sells specialty chemicals worldwide, through three segments: Grace Catalysts, Grace Materials, and Grace Construction Products. Founded in 1854 and headquartered in Columbia, Maryland.
Cash	759m	\$198m	\$186m
LTD	3,326m	\$923m	\$1.6b
Price	68euros	\$60	\$76
Shares	91.5m	62.2m	68.2m
Market Cap	6.2b euros	\$3.7b	\$5.2b
Enter. Value (EV)	8.6b euros	\$4.6b	\$6.6b
Rev - LTM	8.8b euros	\$2.6b	\$1.7b
Adj. EBITDA – LTM	1.3b euros	\$518m	\$527m
Adj. EBITDA – 2016	995m euros	\$489m	\$501m
Adj. EBITDA margin	12.9%	20.3%	31.3%
EV to Adj. EBITDA	7.3x **	8.9x	12.5x
EV to LTM Revenues	1.0x	1.7x	3.9x
LTM Cash from Operations	627m euros	\$280m	\$327m
LTM Capital Expenditures	479m euros	\$118m	\$113m
Cap Ex to Revenues	5.5%	4.5%	6.7%
LTM Free Cash Flow			
FCF to EV			

EV to LTM Cash from Ops.	14.0x	15.9x	20.0x
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** Pro forma for Chemtura (acquired April 21, 2017) and latest 2017 guidance for EBITDA pre.

Catalysts

1. Attractive valuation at about 7x projected EBITDA pre for 2017 (pro forma for Chemtura) and 6.6x our projected 2018 EBITDA pre of 1.3b euros (ex 50% of Arlanxeo).
2. Enhanced investor appreciation and higher multiple due to the greater consistency of financial results from strategic repositioning.
3. We believe lower-margin, more commodity-oriented Arlanexo 50% ownership will represent only 15% of consolidated EBITDA pre in 2018 which should encourage a strong valuation multiple.
4. Growth in adjusted EBITDA from 2017 and 2018 due to Chemtura and synergies and improved results from "New Lanxess" specialty chemical segments
5. Additional niche acquisitions in specialty chemical segments.
6. Strong cash generation and reduction of net debt position post Chemtura.
7. Organic growth through strategic capital expenditures (debottlenecking, additional lines, etc.)
8. Gradual improvement in EBITDA pre for Arlanxeo segment as the specialty rubber market stabilizes.
9. Berkshire Hathaway involvement increases or other M&A activity in specialty chemical industry highlights Lanxess' value.
10. Possible acquisition of Lanxess by a strategic or financial purchaser.

Risks

1. The U.S. and/or global economy declines significantly.
2. Unable to improve EBITDA pre margins and/or grow its revenues.
3. Problems integrating Chemtura.
4. Major problems in the Eurozone or other geopolitical issues.
5. Unexpected competitive actions by major competitors.
6. We are not including net pension liabilities of about 1.3b euros as debt.
7. Misallocation of capital into a poor acquisition.
8. A major accident at a chemical plant.
9. Loss of CEO Matthais Zachert.
10. Significant net debt position after Chemtura, despite investment grade rating.

11. We are defining FCF as cash from operations less maintenance capital expenditures and including non-cash stock comp and some other add-backs which some investors would not want to include.

Disclaimer

Disclaimer: We own shares of Lanxess. We may buy or sell these shares at any time without notice. The information in the write-up is believed to be correct as of the date written but readers should do their own verification of this information and analysis of this potential investment. We undertake no obligation to update this write-up if new information arises at a future date.

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I do not hold a position with the issuer such as employment, directorship, or consultancy.
I and/or others I advise do not hold a material investment in the issuer's securities.

Catalyst

See above

Messages

Subject Projections
Entry 12/11/2017 04:26 AM
Member werd725

Thanks for the write-up, andreas. You lay out a compelling case. Given that your numbers seem to be far ahead of the street estimates, would you mind posting your profit projections for the next couple years and how you derive them?

Many thanks,

Werd

Subject Re: Projections
Entry 12/11/2017 10:15 AM
Member andreas947

Thanks for question. The projections for 2018 are below. EBITDA pre is the metric that management and we have focused on to potentially drive shareholder value here. We don't believe this requires any heroic assumptions, which is one reason why we like this investment idea. Hope this helps. Best, Andreas

Under Zachert, Lanxess has grown EBITDA pre from 735m euros in 2013 to 808m euros in 2014 (10% growth) to 885m euros in 2015 (9.5% growth) to 995m euros in 2016 (12% growth). We believe Lanxess can grow EBITDA pre by about 10% per year in 2017 and 2018 to about 1.1b euros and 1.2b euros, respectively. We believe Chemtura could add about 300m euros in 2018, its first full year under Lanxess ownership. This would result in EBITDA pre of about 1.5b euros in 2018. We would subtract 200m euros for the 50% of Arlanxeo owned by Saudi Aramco, resulting in EBITDA pre of about 1.3b euros in 2018.

Lanxess' enterprise value (EV) post Chemtura is 8.6b euros based on a share price of about 68 euros per share price. Lanxess has most recently guided to 1.23b to 1.3b euros of EBITDA pre for 2017, which includes Chemtura since April 21, 2017, or about 8 months. Pro forma for a full year of Chemtura (about 60m euros of EBITDA per quarter), we believe Lanxess EBITDA pre for 2017 would be close to 1.38b euros (Lanxess results are trending towards the high end of guidance for 2017). In 2018, we expect synergies from Chemtura and continued margin improvement from New Lanxess segments and we believe Lanxess could achieve EBITDA pre of 1.5b euros consolidated or 1.3b euros excluding 50% of Arlanxeo JV. Based on this, Lanxess is trading at about 6.6x our 2018 EBITDA pre (ex 50% of Arlanxeo JV) of 1.3b euros.

We believe Lanxess specialty chemical businesses could eventually be valued at 9x EBITDA pre for 2018 or about 11.7b euros. We believe by year end 2018, Lanxess could reduce net debt to about 1.7b euros for a market cap of about 10b euros or about 110 euros per share, about 65% higher than the current share price.

Subject some good news...
Entry 08/08/2018 11:26 PM
Member andreas947

Lanxess today moved up some because they sold the remaining 50% of Arlanxeo to Saudi Aramco. This is the weaker, more cyclical and volatile rubber business. Net proceeds to Lanxess are close to 1.4b euros and they are left with the resilient, high margin, specialty chemical businesses. It looks like their net debt could drop to about 1b euros at year end when deal closes. We think the remaining specialty chemical businesses can do about 1b euros in EBITDA pre in 2018 and maybe 1.1b euros in EBITDA pre in 2019, unless the global economy completely falls apart. We think these unique and resilient specialty chemical businesses could trade for 9x EBITDA pre for a (roughly) 10b euro EV in 2019. Less 1b euros net debt gets you 9b euro market cap, divided by 91m shares, gets you close to 100 euros per share versus 70 euros today. CEO Matthias Zachert is among the best CEO's we have come across in many years, both on operations and capital allocation. Berkshire Hathaway has boosted their ownership to 5% and is one of the top shareholders. Nothing is ever guaranteed but this is a pretty good bet at these levels in our opinion. Thank you to Pokey for identifying this opportunity in the first place in an earlier VIC write up. We continue to like it.