

Research Update:

Industrial Gas Producer L'Air Liquide Upgraded to 'A/A-1' From 'A-/A-2' On Improved Metrics; Outlook Stable

July 28, 2021

Rating Action Overview

- Since the Airgas acquisition in 2016, L'Air Liquide has continuously lowered its leverage and improved its profitability due to resilient operating performance and high cost savings.
- L'Air Liquide's financial policy supports funds from operations (FFO) to debt to remain above 30%, reflecting prudently balanced capital expenditure (capex), acquisitions, divestitures, and shareholder distributions.
- We therefore raised our long-term and short-term issuer credit ratings on the company to 'A/A-1' from 'A-/A-2'.
- The stable outlook reflects our forecast of L'Air Liquide's adjusted FFO to debt will remain at 30%-35% over the next 18-24 months.

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Rating Action Rationale

Supportive financial leverage management has strengthened the balance sheet. Financial leverage management has been supportive since the Airgas acquisition in 2016, improving gearing to about 56% at year-end 2020 (company-defined unadjusted debt to equity) from 90% over that period. This is driven by balancing sizable and fairly predictable operational cash flow, capex, bolt-on acquisitions, and net debt reduction. We view the shareholder remuneration policy as generally predictable and consistent with profit generation. Although L'Air Liquide has delayed its return on capital employed target of 10% to 2023 or 2024 due to the global downturn and high investment in the accelerating energy transition, it has reached and will maintain adjusted FFO to debt of over 30% (32.8% at end-2020) by our calculations.

Profitability has improved through structural efficiency gains and cost management. L'Air Liquide's S&P Global Ratings-adjusted EBITDA margin improved to 28.2% in 2020 from 25.8% in 2018, supported by efficiency gains under the NEOS program, which we expect to deliver €400

million per year by 2021, similar to the €441 million in 2020. The group's efficiency gains amounted to another €95 million in first-quarter 2021, up 5% year-on-year. These mainly relate to the rollout of digital tools, reduced logistics costs, optimization of the operation of production units, and purchasing gains. Finally, we expect management to continue its proactive strategy of reviewing the asset portfolio to enhance the group's performance sustainably, which resulted in three divestitures this year, but also five bolt-on acquisitions, mainly in Europe and China.

We view L'Air Liquide to be well positioned for growth and the accelerating energy transition

due to historically high investment. A key long-term ambition is to triple its existing €2 billion in sales per year hydrogen business before 2035 through €8 billion in capex. The company also offers various solutions to its customers to decarbonize their industrial assets and production processes and enable the hydrogen economy. As of first-quarter 2021, almost half of its project pipeline was linked to the energy transition and another 25% focuses on electronics. Regionally, Europe and Asia represent almost 75% of investment opportunities. L'Air Liquide estimates that if its investment backlog is fully executed, it will add another €1 billion in sales, which should benefit its EBITDA and cash flows.

Outlook

The stable outlook reflects our view of L'Air Liquide's resilient business and prudently balanced capex, acquisitions, divestitures, and shareholder distributions, which should allow for its credit metrics to remain commensurate with our 'A' rating, including FFO to debt of at least 30% on average. For 2021 and 2022 we anticipate this ratio to remain at 30%-35%.

Downside scenario

We could lower the rating if the group adopts a more aggressive or shareholder-friendly financial policy, leading to increased leverage. Specifically, we would consider a downgrade if adjusted FFO to debt falls below 30% without the prospect of a rebound.

Upside scenario

We could consider an upgrade if adjusted FFO to debt remained sustainably above 35%, and management committed to maintaining it at this level.

Company Description

L'Air Liquide is one of the largest industrial gas suppliers worldwide with presence in 78 countries and about 64,500 employees. About 96% of its sales comes from its gas and services segment (split in four business lines--large industries, industrial merchant, health care, and electronics), and the remainder from engineering and construction, and global market and technologies activities. Its industrial gas products include oxygen and nitrogen produced in air-separation units, and hydrogen and carbon monoxide produced in steam methane reformers. These are sold to metals, chemicals, oil refining, and electronics companies, as well as in the health care, food processing and aerospace markets.

Our Base-Case Scenario

Assumptions

- Revenue growth of 2%-3% in 2021 and 4%-5% in 2022.
- S&P Global Ratings-adjusted EBITDA margin improving to 29%-30% in 2021 and 2022.
- Capex of €2.9 billion in 2021, rising to above €3.5 billion from 2022, driven by growth projects like increasing hydrogen capacity.
- Working capital outflow of €100 million in 2021, driven by higher revenue.
- Modestly growing dividend distributions, with a 55% payout ratio.

Key metrics

L'Air Liquide S.A.--Key Metrics

(Mil. €)	--Fiscal year ended Dec. 31--		
	2020a	2021e	2022f
EBITDA	5.8	6.2-6.3	6.4-6.5
Debt/EBITDA (x)	2.5	2.2-2.5	2.2-2.5
FFO/debt (%)	32.8	32.5-33.5	34-35

*All figures adjusted by S&P Global Ratings. §2020 year-end debt consists of net financial debt of €14.31 billion, with key adjustments being €1.18 billion in leases, €1.17 billion in pension, €1.06 billion in trade receivables sold, and €0.20 billion in ARO debt adjustment. a--Actual. e--Estimate. f--Forecast.

Liquidity

We view L'Air Liquide's liquidity as adequate. This reflects our estimate that liquidity sources will exceed liquidity needs by 1.4x over the 12 months started July 1, 2021.

The company's major liquidity sources for next 12 months starting from April 1, 2021 include:

- €1.2 billion including cash and liquid investments (marketable securities).
- €3.6 billion in an undrawn bank line.
- About €4.5 billion of cash FFO.

Its major liquidity uses for the same period include:

- Debt maturities of €3.3 billion.
- Capex of about €3.3 billion.
- Shareholder remuneration of €1.4 billion.
- Bolt-on acquisitions of €500 million-€600 million.
- Working capital outflows of €100 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of year-end 2020, Air Liquide's capital structure primarily constituted total reported gross debt of €12.4 billion, with bonds and private placements of €11.3 billion, bank debt and other financial debt of €800 million, commercial paper programs of €201 million, and put options of €97 million.

Analytical conclusions

Most of the debt is issued by the group's finance subsidiary--Air Liquide Finance--and guaranteed by holding company L'Air Liquide S.A., in line with its strategy of central financing. We believe the level of structural subordination is marginal. We consider Air Liquide's funding sources well diversified and improving. Risk management policy involves maintaining local debt as the primary financing source in countries considered higher-risk.

Ratings Score Snapshot

Issuer Credit Rating: A/Stable/A-1

Business risk: Excellent

- Country risk: Low
- Industry risk: Low
- Competitive position: Excellent

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: a+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- 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

Related Research

- The Hydrogen Economy: Industrial Gas Companies Are In Pole Position, April 22, 2021

Ratings List

Upgraded; Outlook Action

	To	From
L'Air Liquide S.A.		
Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2

Upgraded

	To	From
L'Air Liquide S.A.		
Air Liquide Finance		
Senior Unsecured	A	A-

Air Liquide Finance

Air Liquide US LLC

L'Air Liquide S.A.

Commercial Paper	A-1	A-2
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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 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 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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