MOODY'S
INVESTORS SERVICE

Credit Opinion: Clariant AG

Global Credit Research - 22 Feb 2011

Muttenz, Switzerland

Ratings

Category	Moody's Rating
Outlook	Positive
Corporate Family Rating	Ba1
Senior Unsecured -Dom Curr	Ba1/LGD4
Clariant Finance (Luxembourg) S.A.	
Outlook	Positive
Bkd Senior Unsecured -Dom Curr	Ba1/LGD4

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Key Indicators

Clariant AG

	Q3 2010 LTM	2009	2008
EBITDA Margin	9.3%	4.7%	8.6%
EBIT / Avg. Assets [1]	7.6%	0.8%	6.1%
Debt / EBITDA	3.1x	7.0x	3.4x
EBITDA / Interest Expense	5.6x	3.0x	5.1x
FFO + Interest / Interest	5.6x	3.7x	5.3x
RCF / Debt [2]	26.1%	12.6%	23.9%
RCF-Capex / Debt [2]	15.1%	2.9%	7.4%
FCF / Debt [2]	19.4%	26.2%	4.0%
Ratios are consistent with Moody's Global Standard Adjustments			

[1] Excludes cash [2] Reduction in share capital treated as dividend

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Headquartered in Pratteln, Switzerland, Clariant AG is a leading international chemicals group. Clariant reported 2010 revenues of approximately CHF 7.1 billion (CHF 6.6 billion reported for 2009).

Rating Rationale

The Ba1 rating reflects our expectation that Clariant will continue to successfully execute the large-scope restructuring programme to consolidate the improvement in the profitability of the core businesses achieved to date and will maintain a strong balance sheet position during the transitionary period. The company is in the process of executing investment and cost cutting measures that have been finalised to re-define its asset footprint and to improve its cost structure, profitability, as well as return on capital, towards product segment averages. Clariant has a strong management team that is executing on this restructuring process, but, in our opinion, there remains execution risk associated with the scope of the on-going investments underway to reposition and realign the assets.

The rating is also positioned to accommodate further potential optimisation of the portfolio, as well as necessary measures to build up the growth platform, following several years of limited investment in R&D and development. The rating is supported by the relatively extended maturity profile of the liabilities, as well as high cash balances. Clariant's track record of conservative balance sheet management and the creditor-friendly stance in managing growth indicated in the proposed funding for the forthcoming Sud-Chemie acquisition continue to underpin the ratings.

Recent Developments

On 16 February, 2011 Clariant announced that it had reached an agreement to acquire German specialty chemical producer Sud-Chemie AG (unrated) for CHF 2.5 billion. The transaction is to be funded by equity (c.CHF 1.1bn), cash (c.CHF 0.5bn) and debt for the balance.

Clariant is trying to shore up improvements in its operations as it emerges from a major restructuring effort over the past two years. The acquisition will accelerate and solidify the recovery in operating performance and reduce uncertainty surrounding Clariant's near-term growth priorities.

Sud-Chemie, which reported sales of EUR 1.2 billion in 2010, enjoys higher margins, is less cyclical than Clariant, and has strong growth prospects from research and development (R&D) investments. It enjoys a strong pipeline of proprietary high-growth technologies. These include lithium battery materials and second-generation bioethanol at a time when the European chemicals industry is shifting its focus towards more profitable and less capital intensive applications driven by R&D, an area in which Clariant currently lags behind.

The transaction, which remains subject to Clariant's shareholders as well as regulatory approvals, will likely accelerate the on-going improvement in the company's performance and strengthen its revenue base. The addition of Sud-Chemie's high-quality revenue base will give Clariant sufficient flexibility to further optimise its business portfolio.

DETAILED RATING CONSIDERATIONS

Business Profile

Clariant's business position in the low-"Baa" category reflects its role as a leading producer of intermediate products with strong market positions in pigments, masterbatches and chemicals for textile and leather. We note a high degree of commoditisation in the company's key markets and increasing competition from lower-cost producers. The company maintains substantial market positions, notwithstanding the consolidation in several market segments following the acquisitions of Cognis and Ciba by BASF. Noting the geographical diversification of the portfolio, we also take into account the company's considerable exposure to highly cyclical end-markets that limits the benefits of diversification and constraints our assessment of the relative quality of the revenue base. Clariant is also relatively exposed to volatile raw materials (ethylene, ethylene oxide, polyethylene, propylene glycol).

Clariant is implementing a broad and comprehensive restructuring of the business to address longer-term structural shifts, such as the commoditisation of the portfolio and the geographical shift in demand. The restructuring plan entails the re-designing of the production chains to lift profitability of the businesses, improve logistics and get proximity to customers and reduce capital employed. The company has already achieved a substantial reduction in the fixed costs (following reductions in personnel and reorganisation of some of the European facilities). In the course of 2011-2013, it plans to further close 22 production sites and relocate part of the production to China (for its ICS division), India (for Pigments and Textile divisions) and Brazil (Pigments) to match the existing demand patterns. We therefore look forward to confirming the key results of such a broad reorganisation within the next 12-18 months.

The company has recently announced its agreement to acquire a Germany-based specialty producer Sud-Chemie AG. The acquisition would help to address growth strategy for Clariant. If the transaction goes ahead, the company will add, on a pro-forma basis, c. 22% to its revenues, including two sizable and more stable businesses (Catalytic Technologies and Absorbents). It will also allow access to a strong pipeline of high-growth products, developed by Sud-Chemie, while Clariant was not active in the development and R&D investment during the restructuring years.

Size and Stability

Clariant's operational size (measured by sales) places it in the "Baa" category. As noted above, we see some limitations to the benefits of diversification with a "Ba" assessment on the number of divisions of equal size. Taking into account the on-going restructuring, we note that exposure to more commoditised markets and highly cyclical end-markets will be reflected in the relatively weak assessment of the stability of its EBITDA. The acquisition of Sud-Chemie, if it goes ahead, should contribute to building a broader and more stable revenue platform, also allowing greater flexibility in optimising the portfolio, if necessary, in the future.

Cost Position

Clariant's historical profitability metrics (measured by Moody's after restructuring costs) do not yet fully reflect the benefits of the on-going restructuring, while the assessment benefits from the strong operating performance in 2010, partially supported by a robust improvement in volumes. The improvement is also supported by estimated CHF 200 m reduction in fixed costs achieved to date, which Moody's regards as an important achievement as part of its broader restructuring initiative.

Since 2005, Clariant has been engaged in restructuring programmes aimed at improving its competitiveness that resulted in an average P&L charge of CHF 120 m per year from 2005-2008. Since the beginning of the last comprehensive restructuring programme, Clariant booked CHF 240 m of restructuring cost in 2009 and guided towards a CHF 320 m cost bill in 2010. Looking into 2011, we expect that the scope of the restructuring programme and the remaining associated costs are now well identified and will be largely expensed, and we also do not expect write-off charges going forward.

Management Strategy

Clariant's historical "Baa" score on this debt leverage focused factor is underpinned by the sustained prudent financial policy. The Ba1 ratings are also supported by Clariant's strong liquidity position and the proactive prefunding of the restructuring process (via the placement of the convertible notes in 2009) that created financial flexibility required for the successful execution of the programme and have guarded against a migration towards a typical sub-investment grade funding structure.

Clariant is facing only limited maturities in 2011 and 2012 and retains an option for conversion of its CHF 300 m convertible bond into equity from March 2012 (subject to share price performance). The positive outlook assigned following the announcement of the proposed acquisition of Sud-Chemie, assumes that Clariant will be able to quickly put in place a long term funding structure to back the transaction.

The conservative approach is also reflected in the proposed funding of the Sud-Chemie acquisition, largely from equity and cash. This assumes an uninterrupted support of the equity investors. We note that Clariant has been able to curtail the shareholders' returns during the restructuring phase, and note the risk that these distributions may need to be increased in the near future, potentially slowing down the pace of the on-going improvement in the financial metrics.

Financial Strength

We continue to focus on the gross debt position of the group, recognising the likely transitional nature of the high cash balances accumulated by the company as a result of a large working capital inflow in 2009, the placement of the convertible bonds and a robust improvement in cash flow generation this year on the back of the recovery.

Looking ahead, we note that successful implementation of the restructuring plan will likely require a higher level of CAPEX over the near term, while we also expect that the company will be gradually returning to the higher levels of investment in the business seen prior to the crisis. During the execution stage, the cash flow generation will also remain affected by the residual restructuring payments, as the company continues to implement the measures already reflected in its P&L. As Clariant is guiding towards further growth in 2011, we note that such growth will require further increase in working capital (in absolute terms), as would higher raw material costs, that we expect will become an even more prominent issue in 2011.

Liquidity

Clariant accumulated a significant cash balance (CHF 1.4 billion at the end of 2010) and is expected to use c.CHF 0.5 b of cash to co-fund the proposed acquisition, while also maintaining a high cash balance to fund its working capital requirements and support liquidity during the refinancing period. The company faces only limited maturities of CHF 130 m in 2011 and CHF 250 m in 2012, while Clariant retains the option to trigger (subject to its share price) a conversion of its convertible notes in March 2012.

Rating Outlook

The positive outlook reflects the conservative funding of the proposed acquisition, with as well as the understanding that Clariant will continue to manage its liquidity and refinancing needs in a proactive manner. Upward rating action would require Clariant to put in place a long term funding structure to back the proposed acquisition.

Continued strong execution of the restructuring programme and the demonstrated ability to control restructuring costs and supporting investment is a key driver behind the change in the outlook.

Drivers of Rating Change

Guidance for upward pressure on the rating continue to include:

- improvement in underlying profitability towards 12% (on an EBITDA basis),

- strong operating cash flow with (RCF-CAPEX) / Debt in mid to high single digits and

- sustained Free Cash Flow generation.

Moody's estimates that the ongoing improvements in Clariant's performance as demonstrated by the company's results for the year to 2010 and the Sud-Chemie acquisition are positive steps towards achieving a higher rating. However, Moody's expectations of a less supportive pricing and volume environment in 2011 could result in a slowdown of the improving trends observed in 2010.

Rating Factors

Clariant AG
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Clariant AG

Chemical Industry	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**
Factor 1: Business Profile						
a) Business Position Assessment			X			
Factor 2: Size & Stability						
a) Revenue (Billions of US$)			USD 7.1b			
b) # of Divisions of Equal Size				3		
c) Stability of EBITDA				20%		
Factor 3: Cost Position						
a) EBITDA Margin (5 Yr. Avg.)				9.0%		
b) ROA - EBIT / Assets (5 Yr. Avg.)				5.4%		
Factor 4: Management Quality						
a) Net Debt / Capital		33%				
b) Net Debt / EBITDA (5 Yr. Avg.)			2.8			
Factor 5: Financial Strength						
a) EBITDA / Total Interest Expense (5 Yr. Avg.)				4.8		
b) Retained Cash Flow / Net Debt (5 Yr. Avg.) [1]			22.5%			
c) Free Cash Flow / Net Debt (5 Yr. Avg.) [1]				5.6%		
Rating:						
a) Indicated Rating from Methodology				Ba		

b) Actual Rating Assigned				Ba1		

[1] Reduction in share capital treated as dividend