MOODY'S
INVESTORS SERVICE

Credit Opinion: Clariant AG

Global Credit Research - 24 Nov 2011

Pratteln, Switzerland

Ratings

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

Contacts

Analyst	**Phone**
Elena Nadtotchi/London	44.20.7772.5454
Olivier Beroud/London	

Key Indicators

Clariant AG

	2010	**2009**	**2008**
EBITDA Margin	**10.2%**	**4.7%**	**8.6%**
EBIT / Avg. Assets [1]	**9.2%**	**0.8%**	**6.1%**
Debt / EBITDA	**3.5x**	**8.4x**	**3.4x**
EBITDA / Interest Expense	**5.4x**	**2.2x**	**4.7x**
FFO + Interest / Interest	**4.9x**	**3.0x**	**4.9x**
RCF / Debt [2]	**20.3%**	**10.3%**	**21.2%**
RCF-Capex / Debt [2]	**8.8%**	**2.1%**	**7.1%**
FCF / Debt [2]	**15.2%**	**21.9%**	**1.6%**

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. In 2010, Clariant reported revenues of approximately CHF 7.1 billion (consolidated revenues of CHF 5.5 billion - for 9 months 2011, inclusive of the contribution by Sud-Chemie AG that Clariant acquired in April 2011 and consolidates it since May 1, 2011).

Recent Results

As a result of slow-down in the economic environment and due to FX pressures, the company has amended its earnings guidance for 2011 indicating lower targeted sales of CHF 7.0 b - CHF 7.2 billion (against earlier guidance of CHF 7.8 b - CHF 8.0 b) and lower average margins of 12.8%-13.2% (against 13.5%-14.5%).

This reflects the performance of more cyclical segments of the business portfolio that registered some decline in margins in 3Q 2011 (such as masterbatches, pigments, as well as textile and leather chemicals) on the back of slowed demand, as well as FX pressure, while the level of profitability for 2011 should remain relatively strong. Looking towards 2012, we expect that the full 12 months contribution of less-volatile businesses of Sud-Chemie, as well as sustained pricing pressure on the key raw materials used by the company (such as petrochemicals) should help Clariant's earnings in the next 12 months in what we expect to be a less supportive operating environment.

Notwithstanding the slowing economic momentum in the 3Q 2011, Clariant's financial metrics remained relatively robust, including LTM (RCF - CAPEX) / Debt stood at 3.5%, while an increase in CAPEX and working capital requirements resulted in a negative FCF position at the end of the quarter.

Rating Rationale

The Ba1 rating is supported by the assessment of the strengthening business profile of the group on the back of the execution of the large-scope restructuring programme and the recent acquisition of the sizable and profitable chemicals business. These measures have improved the scope and quality of the earnings base and created flexibility to consider further portfolio measures, such as divestments and bolt-on acquisitions, to support Clariant's 2015 targets of profitable growth.

Clariant's total debt level has increased in 2011 as a result of the acquisition and is expected to be at approximately CHF 3.2 billion at the end of 2011 (before Moody's adjustments for leases and pension liabilities). We assume some reduction in debt in 2012 (c.CHF 0.5 billion in scheduled repayments, with recent placements of EUR 365m in certificates of indebtedness in the German market supporting the scheduled repayments in the next 12 months). With investment in the improvement of the business weighting on the FCF generation in 2012, further reduction in leverage in the next 12-18 months is expected to come mainly from the growth in earnings, which we expect will be slower in 2012.

Clariant's track record of conservative balance sheet management and the creditor-friendly stance in managing growth indicated in the funding for the Sud-Chemie acquisition also continue to underpin the ratings.

DETAILED RATING CONSIDERATIONS

Restructuring and acquisition of Sud-Chemie underpin strengthening business profile

Balancing credit considerations include (a) earnings exposure to the cycle and raw material price changes, notwithstanding the positive effects of the acquisition and restructuring, that added to the resilience of the business; (b) some integration risk on Sud-Chemie operations and some residual risk associated with the execution the closures and realignment of the production assets; (c) forex sensitivity, as well as (d) some uncertainty associated with the scope and timing of the portfolio measures and disposals, indicated as part of the business development plan.

Strong execution of the comprehensive restructuring measures initiated by the management team in 2008 has improved the business risk profile of Clariant. The restructuring plan focused on re-designing of the production chains to lift profitability of the businesses, improve logistics and get proximity to customers, as well as reduce capital employed. Clariant has achieved a substantial CHF 200 m reduction in fixed costs (following reductions in personnel and reorganisation of some of the European and Swiss facilities) and is finalising the closure of production sites and relocation of 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.

The acquisition of Sud-Chemie AG in 2011 have accelerated the improvement in the business, as it has added to the scale and quality of the company's revenue base. It has reduced the uncertainty regarding Clariant's near term growth strategy and provided flexibility for further portfolio measures, as recently confirmed by the company. We view these measures, together with the CAPEX commitments underpinning capacity rationalisation, to be building on the results of the comprehensive restructuring programme and reflected in improved level of profitability.

While we expect that the high level of profitability achieved by Clariant in 2010/2011 was partially helped by the up-cycle conditions in the industry, that we expect to ease going into 2012, the targeted EBITDA margin of 12.8% - 13.2% for 2011 also reflects the reduction in fixed costs and the decline in the exceptional charges, related to the restructuring. Looking ahead, we expect that the company has also funded the majority of the cash costs, associated with the restructuring effort. Following the acquisition of Sud-Chemie, Clariant designed a number of additional rationalisation measures for 2011/2012 and expects the synergy benefits of CHF 75-95 million in earnings in the medium term.

Our view of the improving business profile is predicated on the expectation of declining volatility in the earnings going forward, supported by the addition of less volatile businesses of Sud-Chemie AG. We estimate that the volatility in EBITDA should fall towards mid-twenties percentage range going forward from over 30% historical level. Furthermore, Clariant has indicated that it may consider some divestments in the near future. We expect that such portfolio measures will likely be directed towards more commodized and less profitable divisions, that should support the improvement in earnings stability as well.

Conservative management of financial profile in spite of adding debt following the acquisition

Clariant has a strong track record of prudent balance sheet management and effective control of the cost of capital. Following a period of restructuring, the company has made a sizable acquisition, conservatively co-funded with cash and equity.

As a result, Clariant has increased the level of debt, as it has raised CHF 400 m in bridge funding, CHF 300 m bonds and assumed c. CHF 528 m in short-term liabilities of Sud-Chemie AG. (Before Moody's adjustments, its gross debt stood at CHF 2.9 billion at the end of 3Q 2011).

The company is currently putting in place a long-term funding structure for the acquisition, having successfully prefunded its 2011 and 2012 maturities (including Sud-Chemie's loans). Clariant has a EUR 600 m bond maturing in 2013. Since 2009, the company maintains high cash balances (of CHF 1.0 billion at the end of 3Q 2011) that support its refinancing effort.

Pending the refinancing, we continue to focus on the gross debt position of the group, recognising the use of part of the cash balances to back up uncommitted short-term bank funding of working capital, as well as potential use of the remaining cash balances to optimise the capital structure.

Liquidity

Following the acquisition, Clariant has placed CHF 300 million in Swiss Franc bonds and EUR 365 million in certificates of indebtedness in the German market, addressing its maturities in 2011 and forthcoming maturities in 2012. In addition, Clariant will face CHF 400m maturity of its acquisition bridge loan facility in March 2012 (extendable by 1 year) and has a further EUR 600 m bond maturing in 2013. The company maintains a significant cash balance (CHF 1.0 billion at the end of 3Q 2011) that supports the liquidity position. We expect that at the end of October, the cash balances have increased to CHF 1.4 billion, following the placement of EUR 365 m in German certificates of indebtedness and the scheduled repayment of EUR 100m.

As part of the restructuring, Clariant has improved the efficiency of its working capital management (reducing the NWC requirement from 21.3% in 2009 to below 20% in 2011). As for any chemicals business, Clariant's net working capital requirement is a significant part of the capital structure. In the absence of committed working capital lines, the company finances its working capital requirements under c. CHF 1 billion of uncommitted facilities maintained with c. 60 banks. The company's cash balance is therefore partially used to "back-stop" this arrangement (CHF 350 m - CHF 450 m). In the first 9 months of 2011, the company had c. CHF 405 m in working capital outflow (including additional net working capital taken over from Süd-Chemie), that we expect to start reversing in 4Q 2011, as growth in volumes and prices eases. Clariant is reviewing the existing working capital financing at Sud-Chemie with the view to improve the efficiency of the targets' working capital after the "squeeze out" process if completed.

Rating Outlook

The stable outlook reflects the expectation of a gradual debt reduction in 2012, that will support the credit profile in what we expect to be a less supportive operating environment.

The stable outlook is underpinned by the expectation that Clariant will maintain a strong liquidity profile and will proactively manage its remaining refinancing requirements (including a gradual refinancing of c.CHF 528 million in bank facilities of Sud-Chemie AG with the view to minimise structural subordination in the consolidated debt structure over a period of time).

What Could Change the Rating - Up

Taking into account the on-going slow down in the operating environment, the upgrade of the ratings would likely require a further reduction in debt. We maintain our financial guidance that an improvement in the leverage profile with (RCF-CAPEX) / Debt in mid to high single digits, Total Debt / EBITDA sustained below 3.0x and consistent FCF generation would be required to support an upgrade of the Ba1 ratings.

What Could Change the Rating - Down

A deterioration in the operating performance leading to a weaker financial profile Total Debt / EBITDA sustained above 4x, RCF / Total Debt at or below 20% would put a negative pressure on the ratings.

Rating Factors

Clariant AG
600017356

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$)			$7.7			
b) # of Divisions of Equal Size			4			
c) Stability of EBITDA					31%	
Factor 3: Cost Position						
a) EBITDA Margin (5 Yr. Avg.)				9%		
b) ROA - EBIT / Assets (5 Yr. Avg.) [1]				5.7%		
Factor 4: Management Quality						
a) Net Debt / Capital			43%			
b) Net Debt / EBITDA (5 Yr. Avg.)			2.7			
Factor 5: Financial Strength						
a) EBITDA / Total Interest Expense (5 Yr. Avg.)				4.7		
b) Retained Cash Flow / Net Debt (5 Yr. Avg.) [2]			25.2%			
c) Free Cash Flow / Net Debt (5 Yr. Avg.) [2]			13.4%			
Rating:						
a) Indicated Rating from Methodology			Baa			
b) Actual Rating Assigned				Ba1		

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