

Global Credit Research - 30 Mar 2010

Muttenz, 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

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Key Indicators

Clariant AG	2009	2008	2007
EBITDA Margin	4.7%	8.6%	8.8%
EBIT / Avg. Assets [1]	0.8%	6.1%	4.8%
Debt / EBITDA	7.0x	3.4x	3.8x
EBITDA / Interest Expense	3.0x	5.1x	4.9x
FFO + Interest / Interest	3.7x	5.2x	4.7x
RCF / Debt [2]	12.6%	21.5%	17.4%
RCF-Capex / Debt [2]	2.9%	9.8%	6.3%
FCF / Debt [2]	26.2%	1.6%	6.1%
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 Muttenz, Switzerland, Clariant AG is a leading international specialty chemicals group. In the fiscal

year ended in December 2009, Clariant reported revenues of approximately CHF 6.6 billion.

Rating Rationale

The Ba1 rating and the stable outlook reflects our current expectation that Clariant will successfully address the structural weakness in profitability before the next refinancing, and will maintain strong balance sheet position following the restructuring. The company is in the process of re-defining its asset footprint (including reduction in the European capacity) and product complexity to reconcile with the reduced level of demand and to lift its profitability and return on capital towards the segment averages. We expect that management will conclude the restructuring and provide strategic guidance for the targeted business profile and liability structure by the end of 2010. Clariant has a strong management team that controls the restructuring process, but, in our opinion, there is still significant execution risk associated with the restructuring as recovery in the company's markets remains relatively weak.

In the near term, the Ba1 rating is also supported by the relatively extended maturity profile of the liabilities, as well as high cash balances, while the company funds its liquidity and restructuring requirements from cash balances and operating cash flows.

Rating Drivers

Based on five-year (2005-09) historical data, weighting of all 11 criteria in Moody's Global Chemical Industry Rating Methodology would place Clariant in the "Ba" category. The Ba assessment of the business profile also reflects our expectation of some improvement in profitability with improved production presence in high-growth geographical areas. The financial assessment is supported by the company's conservative balance sheet management and financial policies, while we recognise that the cash flows of the group will likely be affected by legacy restructuring charges for some time after the targeted conclusion of the restructuring.

The key rating factors currently driving the rating are:

Factor 1 - Business Profile: Clariant's business position in the mid-"Baa" category reflects its role as a leading producer with strong market positions in pigments, specialty masterbatches and chemicals for textile and leather, colorants and printing. We note a high degree of commoditisation of the portfolio that is reflected in a relatively high degree of volatility in revenues, exacerbated by the on-going restructuring and the depth of the downturn in 2009. While Clariant maintains strong market positions, we note that it operates in a highly-competitive environment and faces stronger competition in pigments and paper chemicals (following the acquisition of Ciba by BASF), as well as competition from lower-cost producers in textile chemicals. Noting the 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 constraint our assessment of the relative quality of the revenue base.

In January 2010, Clariant moved from a divisional structure to 10 business units ("BUs") that have been previously arranged into four larger divisions. The Industrial and Consumer Specialties (ethylene oxide derivatives), Masterbatches and Pigments business units remain the largest contributors to the company's top line (accounting for 21%, 17% and 16% of 2009 sales respectively). Clariant is relatively exposed to volatile raw materials (ethylene, ethylene oxide, polyethylene, propylene glycol).

The Baa assessment of the Business profile is underpinned by the expectation of a timely and successful restructuring that will allow Clariant to fully benefit from larger-scale production facilities, better logistics and a lower fixed cost position supporting its existing selected profitable client relationships.

Factor 2 - Size and Stability: Clariant enjoys a meaningful size of operations (measured by sales) that places it in the "Ba" 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 (3 divisions accounting for 63% of 2009 revenues). We further note that the level of commoditisation of the portfolio and exposure to highly cyclical end-markets will be reflected in the relatively weak assessment of the stability of its EBITDA.

Factor 3 - Cost Position: Clariant's historical profitability metrics (measured by Moody's after restructuring costs) are underpinned by the strong operating environment in 2006-2008 and do not fully reflect the current weakness in profitability. The overall "Ba" assessment is supported by the expectation of improved profitability in the next 12-18 months.

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. In 2009, the new management team initiated a broader operating restructuring. The goal is to lift Clariant's profitability and return on assets by implementing fixed cost cutting measures, reducing the asset base and rationalising key operating processes. In 2009, Clariant booked CHF 240 m of restructuring cost and guided for another 12 months of restructuring with a

similar cost bill, as in 2009.

Moody's notes that the company continues to enjoy a relatively low WACC, further supported by the placement of CHF 300 m convertible notes in 2009. The assessment of the Cost Position is underpinned by the expectation that Clariant will lift profitability levels before the next refinancing.

We note that commodity producers benefited in 2009 and early 2010 from the robust level of Asian demand that allowed higher levels of capacity utilisation and allowed commodity chemicals producers to avoid large price cuts. A weakening demand in emerging economies would present an additional downside risk for the credit.

Factor 4 - Management Strategy: Clariant's "Baa" score on this debt leverage focused factor is underpinned by the sustained prudent financial policy, but also reflects the deterioration in the leverage position during the economic downturn. Moody's notes the increased focus on portfolio management, but takes comfort from the management's reiterated view that the group's strategy does not accommodate debt-financed acquisitions at this stage, as well as its stated intention to maintain a conservative financial policy to support the on-going restructuring of the operations. Furthermore, we see the decision of the board not to pay a dividend for 2009 as supportive to the credit profile.

Factor 5 - Financial Strength: At this junction of the cycle, the financial position remains weak, as the company continues to fund substantial restructuring costs out of operating cash flows that remain affected by the economic downturn. In 2009, the financial position was largely supported by the placement of the convertible notes and a substantial working capital inflow that we do not expect to be repeated in 2010. Looking ahead, the assessment is supported by the expectation of restored profitability position and contained cost of capital, as well as conservative balance sheet and liquidity management. The assessment also prospectively assumes a recovery in the FFO generation in 2010. As Clariant is guiding towards some growth from 2011, we note that such growth will require higher working capital commitments (in absolute terms) and potentially higher investments (from the historically low levels of 2009).

Following the conclusion of the restructuring process, the liability structure is likely to evolve further, particularly after the refinancing of 2013.

Liquidity

At the end of 2009, Clariant reported CHF 1.1 b in cash balances that was supported by the CHF 463 m inflow of working capital during the year.

The company has cancelled its maturing committed syndicated back-stop facility. Clariant finances its operations largely from the cash balances and cash flow. We note that the company has no refinancing needs until 2013 when the EUR 600 m Eurobond will mature. We note that the cash balances should allow sufficient flexibility to cover maturities in 2011 (certificate of indebtedness of EUR 100m) and in 2012 (CHF 250m bond), as well as potential increase in working capital and CAPEX, should the operating environment continue to improve for the company.

Rating Outlook

The stable outlook on the Ba1 ratings prospectively assumes that operating results will begin to reflect a sustained positive momentum in profitability and stronger operating cash flow generation leading to recovery in the interest coverage with $(\text{FFO} + \text{Interest}) / \text{Interest}$ recovering to above 4x times during the first half of 2010 and sustained RCF/Debt in mid-teens. While substantial cash balances reported at the end of 2009 should provide flexibility to manage WC funding needs in the near term, the stable outlook anticipates that Clariant will proactively manage its medium term refinancing needs. We caution that a lack of a back-up funding arrangements in advance of the refinancing in 2013 may lead to a deterioration in the liquidity position, particularly in a growth environment, and lead to a downgrade of the outlook and the rating. Any evidence that the required recovery in 2010 is not going to lead to Clariant achieving the return to the guidance set below will lead to downgrade pressure.

What Could Change the Rating - Up

A strong trend improvement in underlying profitability towards 12% (on EBITDA basis) underpinned by the successful and timely restructuring leading to robust operating performance, as well as strong operating cash flow with $(\text{RCF} - \text{CAPEX}) / \text{Debt}$ in the high single digits and sustained FCF generation would generate positive pressure on the rating.

What Could Change the Rating - Down

The rating could be downgraded should Clariant experience some additional erosion in its operating profitability, despite the ongoing efforts, or suffer additional costs / delays in the implementation of the restructuring. A sustained weakness in cash flow generation and leverage, with expectation of sustained negative $(\text{RCF} - \text{CAPEX}) / \text{Debt}$ generation and sustained negative FCF generation beyond 2010 will put negative pressure on the ratings.

The ratings on the bonds may be downgraded if the company were to raise secured debt. We note that at the end of 2009, Clariant had approximately CHF 132 million outstanding under bilateral working capital / roll-over loans raised by its operating subsidiaries.

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



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