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Summary:
Clariant AG

Primary Credit Analyst:

Tobias Mock, CFA, Frankfurt (49) 69-33-999-126; tobias_mock@standardandpoors.com

Secondary Credit Analyst:

Lucas Sevenin, Paris (33) 1-4420-6661; lucas_sevenin@standardandpoors.com

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Summary:

Clariant AG

Credit Rating: BBB-/Negative/A-3

Rationale

The ratings on Switzerland-based specialty chemicals manufacturer Clariant AG reflect the company's satisfactory business profile as a leading producer of specialty chemicals and its intermediate financial risk profile. The ratings are supported by the company's strong regional, product, customer, and end-market diversification.

Clariant is a leading producer of pigments used in paints, dyes, and plastics. It also has a leading market position as a producer of surfactants and bleach activators for detergents. The ratings are constrained by the company's volatile cash flows, which are linked to economic cycles. In addition, a negative rating factor is Clariant's continuously weak profitability and only modest operating cash flow generation over the past few years, despite the introduction of significant restructuring measures.

Key business and profitability developments

Clariant's profitability in the first quarter of 2009 suffered from a 25% year-on-year decline in volumes sold and a material underutilization of production assets to relief working capital. The company reported very weak profitability in first-quarter 2009, with an EBITDA margin of about 2.7%, before exceptional items.

This compares with a reported EBITDA margin of 9.7% as of year-end 2008, which was also below the average of rated chemical companies in Europe. Clariant's return on capital has consistently been about 6% in recent years and remains weak. The company has initiated several restructuring programs, totaling between Swiss franc (CHF) 250 million and CHF300 million, to reduce its variable and fixed-cost base to counteract the severe volume decline in 2009. In addition, lower raw material costs should support profitability somewhat throughout 2009. However, profitability is expected to remain clearly below 2008 levels for the full year, with further improvements largely depending on the severity of the volume decline.

Key cash flow and capital-structure developments

Cash flow generation benefited in first-quarter 2009 from a significant release of working-capital inflow of CHF210 million, reaching CHF156 million, compared with negative CHF6 million for the same period in 2008. However, cash flow generation (before working capital deductions) was extremely weak, reflecting the high idling costs of production facilities and weak profitability. Key credit protection ratios weakened considerably, with FFO-to-debt for the 12 months ended March 31, 2009, reaching 19% compared with about 30% at year-end 2008. Debt to EBITDA rose to 3.3x at the end of March compared with 2.5x as of year-end 2008. We expect key credit metrics to weaken in 2009, the extent of which will largely depend on the evolution of volumes during 2009.

Liquidity

Clariant's liquidity position is currently adequate. The group had CHF438 million in cash and cash equivalents as of March 31, 2009. In addition, its CHF750 million revolving credit facility (RCF), maturing in 2010, was undrawn. Clariant is in the process of renegotiating certain terms and conditions, including the financial covenants, to allow

for adequate headroom in the currently difficult market environment. The size of the RCF is likely to decrease to CHF550 million or less at the company's discretion. Clariant obtained the applicable majority lenders' consent required to amend certain terms and conditions of the revolving credit facility on June 30, 2009.

Furthermore, Clariant issued a convertible bond of CHF 300 million on July 2, 2009, with settlement planned on July 7, 2009. This will create additional financial headroom and improves the company's liquidity position.

Clariant had short-term debt obligations of CHF261 million on March 31, 2009, largely comprising financial obligations at subsidiary level that we believe Clariant will roll over. Clariant's debt-maturity profile is good, with the next significant maturity due in 2011--a "Schuldschein" (promissory note) of €100 million.

We expect Clariant's cash flow generation to be positive in 2009 as a result of a material reduction in working capital and capital expenditures, which should support the company's liquidity. In addition, we consider it unlikely that Clariant will make dividend payments or shareholder returns in 2009.

Outlook

The negative outlook reflects our expectation that Clariant is likely to suffer severe volume declines, which will heavily affect profitability and put pressure on the current rating.

For the current 'BBB-' rating, we would expect Clariant to maintain FFO to debt of about 30% through the economic cycle. The rating could come under pressure if volumes decline more than 15% for the full year 2009 and recover only moderately in 2010 because this would make it unlikely that Clariant would be able to maintain adequate credit protection ratios for the present rating.

We consider an outlook revision to stable currently unlikely, owing to the difficult economic environment. However, an outlook revision could occur if the company manages to materially improve its profitability, achieve a significant improvement in volumes sold in the course of 2009, and if its profitability can benefit from the lower raw material costs.

Additional Contact:

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Additional Contact:

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

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