

Research Update:

Swiss Chemicals Company Clariant Affirmed At 'BBB-/A-3'; Off Watch; Outlook Negative On Medium-Term Deleveraging Risks

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Overview

- Swiss chemicals company Clariant intends to acquire Süd-Chemie, which we believe will strengthen the company's profitability and diversity.
- The acquisition amount is significant, however, and we expect deleveraging to happen only over the medium term, given expected negative free cash flow in 2011.
- We are affirming our 'BBB-/A-3' ratings on Clariant, and removing the ratings from CreditWatch with negative implications.
- The negative outlook reflects our forecast that financial metrics will fall short of rating expectations in 2011, with medium-term deleveraging dependent on sustaining or further raising profitability.

Rating Action

On March 14, 2011, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term and 'A-3' short-term corporate credit ratings on Swiss chemicals company, Clariant AG, and removed the ratings from CreditWatch, where they were placed on Feb. 17, 2011. The outlook is negative.

Rationale

Our rating action results from Clariant's announcement, on Feb. 16, 2011, that it intends to acquire German chemicals producer Süd-Chemie AG for a total transaction value of about Swiss franc (CHF)2.5 billion, CHF1.5 billion of which will be debt funded.

We believe that Clariant's business risk profile benefits from the acquisition but that its financial risk profile will be weakened. Accordingly, we are revising our assessment of the business risk profile to "satisfactory" from "fair" and of the financial risk profile to "significant" from "intermediate."

The positive impact of the acquisition on Clariant's business risk profile comes from Süd-Chemie's catalyst and adsorbents business, which we believe will enhance Clariant's segment diversity and global footprint as well as its exposure to more stable and higher growth end-markets. We also observe that Süd-Chemie's activities enjoy higher margins and growth rates than Clariant's existing portfolio and will help reduce cyclicalities, as evidenced by the historically more stable profit generation of Süd-Chemie. Our reassessment of Clariant's business risk also factors in the company's success in strongly

improving profitability in 2010. That said, execution of its restructuring plan and integration of Süd-Chemie still involves a degree of risk, with full upside in profitability to be seen only by 2013.

At the same time, the acquisition will lead to a deterioration of Clariant's financial risk profile, despite the transaction being about 40% equity financed and Clariant's net debt having fallen to a mere CHF0.1 billion at year-end 2010. A particular weakness is that we expect deleveraging to occur only in 2012 and 2013, as Clariant's 2011 free cash flow is likely to be more negative than previously anticipated, due to cash restructuring outlays, integration costs for Süd-Chemie, as well as working capital outflows and investments that are higher than previously assumed. We forecast net financial debt rising to about CHF1.9 billion at the end of 2011 (or CHF2.7 billion after our adjustments) under our credit scenario. We consequently forecast that the ratio of adjusted funds from operations (FFO) to debt will drop to a modest 23% in 2011. Under our credit scenario, we expect the ratio to recover to 28% in 2012 and 33% in 2013, on the basis of decreasing debt. Our credit base-case forecasts also include EBITDA in the order of CHF1.0 billion-CHF1.1 billion over 2011-2013. This does not factor in all the upside that could come from growth or synergies, nor does it take into account the downside that would result from an unexpected weakening of the macroeconomic environment and/or related margin pressures.

Clariant is a producer of a wide variety of industrial and consumer specialties and pigments used in paints, dyes, and plastics. It also has leading market positions in leather and textile chemicals, surfactant, and bleach activators for detergents. The Süd-Chemie acquisition adds adsorbents and catalysts to Clariant's business mix as well as a portfolio of proprietary technologies in the high-growth areas of energy storage and renewable energy.

Liquidity

We assess that Clariant's liquidity position will be "adequate" following the acquisition of Süd-Chemie.

Liquidity sources should include:

- CHF1.4 billion in cash and equivalents on Dec. 31, 2010, of which we treat CHF150 million as tied to operations.
- A CHF1.12 billion bridge facility, with a maturity of up to two years from closing of the acquisition of Süd-Chemie.
- FFO of about CHF600 million.

This compares with:

- CHF240 million of short-term maturities. Debt maturities in 2012 are also modest, at CHF250 million.
- Investments of about CHF450 million as well as assumed working capital outflows of a few hundred million.
- A sizable cash outlay of CHF1.5 billion in relation to the CHF2.5 billion Süd-Chemie acquisition, assuming CHF1.0 billion will be equity funded.

We understand that Clariant plans to refinance part of the CHF1.12 billion bridge facility due March 2013 within the 12 months following closure of the acquisition. This will be important in our assessment of Clariant's future liquidity, notably bearing in mind the sizable €600 million bond maturity in 2013.

The acquisition bridge facility includes a debt-to-EBITDA covenant. We currently estimate covenant headroom to be comfortable, at about 30% under our scenario.

Outlook

The negative outlook reflects uncertainty in relation to the pace of future deleveraging, notably as we factor in negative free cash flow in 2011. Near-term adjusted FFO-to-debt ratios are therefore likely to be below the 30% we see as consistent with the ratings. This ratio guidance is based on mid-cycle EBITDA we use in our credit scenario.

We could lower the rating if Clariant fails to show progress in deleveraging by mid- to end 2012, which will also depend on sustainability of improvements in its profitability and successful integration of Süd-Chemie, as well as a sufficiently supportive global macro-economic environment. A downgrade could also arise if the company has not refinanced a major part of the CHF1.12 billion acquisition bridge facility within the next 12 months.

To revise the outlook to stable we would expect to see adequate progress or increased visibility on refinancing and deleveraging, and related improvement in credit metrics.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Key Credit Factors: Business and Financial Risks In The Commodity And Specialty Chemical Industry, Nov. 20, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Clariant AG		
Corporate Credit Rating	BBB-/Negative/A-3	BBB-/Watch Neg/A-3
Senior Unsecured	BBB-	BBB-/Watch Neg

Clariant Finance (Luxembourg) S.A.
Senior Unsecured*

BBB-

BBB-/Watch Neg

*Guarantor: Clariant AG

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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) 495-783-4011.

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