

Research Update:

Clariant Outlook Revised To Stable On Significant Debt Reduction And Improved Sector Prospects; 'BBB-' Ratings Affirmed

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Overview

- Debt reduction at Swiss specialty chemical group Clariant over the past 15 months has exceeded our expectations.
- Operating performance at Clariant has strongly recovered over the past three quarters and 2010 should see a strong rebound.
- We are revising the outlook on Clariant to stable from negative and affirming our 'BBB-/A-3' ratings.
- The stable outlook factors in the group's financial flexibility from its sizable liquidity, as well as our expectation of improved operating performance and credit metrics in 2010 and 2011.

Rating Action

On May 4, 2010, Standard & Poor's Ratings Services revised its outlook on Switzerland-based specialty chemical group Clariant AG to stable from negative. At the same time, we affirmed our 'BBB-/A-3' long- and short-term corporate credit ratings on Clariant AG.

Rationale

The outlook revision to stable takes into account Clariant's larger-than-anticipated free cash flow generation and net debt reduction over the past 15 months and the building up of very comfortable liquidity. It also reflects a noticeable improvement in recent operating performance and an improved industry outlook for 2010 thanks to a marked recovery in chemical volumes.

We recognize the group's strongly improved financial risk profile, but at the same time we have lowered our assessment of the group's business risk profile to "fair" from "satisfactory." This is because Clariant's profit margins have been materially lower than peers', notably dragged down by large recurring restructuring charges. In this respect, we will monitor management's success in raising returns on capital and EBIT margins in 2011 through sustainable reductions in costs and complexity, as well as pricing discipline.

The ratings on Clariant reflect our view of the group's "fair" business risk profile as a leading producer of specialty chemicals and its "intermediate" financial risk profile, according to our criteria. 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, surfactants, and bleach activators for detergents.

We expect Clariant's profitability to recover strongly in 2010. Under our credit scenario, we forecast EBITDA before restructuring charges of more than Swiss franc (CHF)700 million, on the basis of an assumed 7% rise in volumes. In 2009, EBITDA before restructuring reached a mere CHF470 million as a result of the unprecedented 14% volume decline, large impairments, and high idling costs of production facilities. We also expect EBITDA margins (before restructuring) to bounce back to approximately 10% in 2010 from a low 7.5% in 2009. First-quarter 2010 EBITDA (before restructuring) reached a peak of CHF235 million, but we share management's prudent view on the second half of 2010, as the economic recovery remains fragile, some of the recent volume recovery may not be sustainable, and pricing pressures could increase. Finally, we expect Clariant's adjusted ratio of funds from operations (FFO) to debt to recover to 35% or above in 2010 and 2011, in line with the current rating (after only 23% in 2009).

Liquidity

We view Clariant's liquidity position as "strong." The group had CHF1.2 billion in cash and cash equivalents on March 31, 2010. This contrasts with CHF135 million of short-term debt, while we expect free operating cash flow to be close to neutral in 2010 under our credit scenario. The group's medium-term debt maturities also remain modest, with the large €600 million bond maturity scheduled for April 2013.

As a result of the large liquidity build-up, Clariant cancelled its syndicated back-stop facility earlier this year. If and when liquidity decreases, we would expect the group to put back in place some committed backup lines.

Outlook

The stable outlook reflects our view that Clariant's financial flexibility has strongly improved through the build-up of a sizable liquidity cushion, which allowed a large reduction in net debt. It also factors in the improved industry outlook, although we remain prudent with regard to the fragile economic outlook and demand in the second half of 2010. For the current 'BBB-' rating, adjusted ratios of FFO to debt of 30%-35% would be commensurate with the rating; we would expect the ratio to exceed 35% under favorable market conditions, and not be far from away from 30% during a downturn.

The rating could come under pressure if Clariant's profitability and credit metrics do not improve as anticipated in 2010 and future years, or if the group makes midsize cash-funded acquisitions--currently not expected. We consider upward rating movement as unlikely as we currently see Clariant's rating as constrained by the sensitivity of its chemical product portfolio to economic cycles and by the near-term uncertainty of Clariant's success in restructuring and restoring profitability to a sustainably higher level.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Industry Report Card: Pared Down Cost Bases And A Solid Start To 2010 Indicate Improved Credit Quality For Europe's Chemical Firms, April 26, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

| | To | From |
|------------------------------------|-----------------|-------------------|
| Clariant AG | | |
| Corporate Credit Rating | BBB-/Stable/A-3 | BBB-/Negative/A-3 |
| Senior Unsecured | BBB- | |
| Clariant Finance (Luxembourg) S.A. | | |
| Senior Unsecured* | BBB- | |

*Guaranteed by Clariant AG

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