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Summary:

Clariant AG

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Credit Rating: BBB-/Stable/A-3

Rationale

The ratings on Switzerland-based specialty chemicals manufacturer Clariant AG reflect our view of the company's "intermediate" financial risk profile and "fair" business risk profile. Clariant's product portfolio comprises a very wide spread of industrial and consumer specialty chemicals, pigments, additives, emulsions, surfactants and bleach activators, as well as oil, textile, and leather chemicals. The company also processes masterbatches for plastics.

The company's fair business risk profile currently constrains the ratings. We view Clariant's EBITDA margins and profitability as lower than peers', affected by the costs of the ongoing large restructuring program that aims to optimize the group's production network and reduce its relatively high cost base. The other key weakness is the cyclical nature of the chemicals industry and its exposure to volatile raw material costs. Key strengths are Clariant's wide product range, and its fairly diversified global sales pattern with 27% in emerging growth markets. Other positives are the strongly improved near-term chemical environment and management's objective to structurally improve profitability from 2011.

We qualify Clariant's financial risk profile as intermediate. This reflects strongly improved credit metrics following a large reduction in financial debt in 2009 and first-half 2010. Other strengths are the group's strong liquidity and favorable medium-term debt maturity profile.

Key business and profitability developments

We expect Clariant to post record 2010 profits in line with the rest of the chemical industry. Clariant's recovery has been impressive, with volumes up 20% in the first half of 2010, almost fully offsetting the severe volume drop experienced in early 2009. Under our credit scenario, we believe 2010 unadjusted EBITDA before restructuring charges should exceed last-12-month EBITDA of Swiss franc (CHF)823 million on June 30, 2010. Reported EBITDA margins also jumped to 13.4% in the first half of 2010, compared with approximately 9%-11% before the 2009 downturn. Restructuring charges of up to CHF300 million in 2010 will, however, continue to weigh on profits this year. Implemented cost reductions and efficiencies from the large restructuring program should contribute to structural improvements from next year; at the same time, in our current credit scenario we factor in that 2011 volume growth should be minimal and that EBITDA margins may moderate somewhat compared with 2010.

Key cash flow and capital-structure developments

We anticipate that Clariant's adjusted ratio of funds from operations (FFO) to debt in 2010 may be 50% or above % (it was 47% over the last 12 months to end-June 2010 [LTM]), more than doubling from the 2009 low of 23%. We expect medium-term unadjusted FFO to stay close to CHF500 million (LTM: CHF515 million), compared with capital spending in the CHF200 million-CHF300 million range (LTM: CHF154 million).

The group's current balance sheet incorporates significant financial flexibility. We will monitor the company's future use of its very high cash balances (CHF1.2 billion at end-June 2010 in comparison with gross debt of CHF1.6 billion). Clariant's adjusted debt stood at CHF1.2 billion at end-June 2010.

Liquidity

We view Clariant's liquidity position as "strong" at end-June 2010.

We estimate liquidity sources over the next 12 months at about CHF1.5 billion, including:

- A very sizable CHF1.2 billion in cash and cash equivalents at end-June 2010, of which we treat CHF150 million as tied to operations; and
- Our estimate of FFO at or above CHF500 million.

This compares with liquidity uses over the next 12 months of CHF0.4 billion, comprised of:

- CHF158 million of short-term working capital-related debt at subsidiaries. Maturities are also modest in 2011 and 2012, while a large €600 million bond maturity is scheduled for April 2013;
- Expected modest negative working capital; and
- Capital spending that we assume to be in the order of CHF200 million-CHF250 million.

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 the significant financial flexibility achieved by Clariant as a result of its significant debt reduction. It also factors in our expectation of a supportive near- to medium-term chemical environment. In view of strongly reduced debt, ratings incorporate some headroom for a modest acquisition. For the current 'BBB-' rating we would expect adjusted ratios of FFO to debt of 35%-40% under mid-cycle chemical conditions. In favorable years, like 2010, we would expect this level to be exceeded.

The rating could come under pressure if adjusted FFO to debt ratios were to fall significantly below 30% in a downturn without near-term prospects of recovery. Pressure could also arise if the group uses its large cash balances for a large acquisition, albeit currently not expected. We see rating upside as limited in the near term, as we would likely want to see a track record of structurally improved profitability and better operational resilience in a downturn than in 2009, in addition to a commitment to continued modest debt.

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