

Clariant AG

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Major Rating Factors

Strengths:

- Leading producer of a broad range of specialty chemicals, including pigments for paints, dyes, and plastics
- Good regional, product, and end-market diversification
- Substantial restructuring program and push for innovation, which is likely to improve profitability

Corporate Credit Rating

BBB-/Negative/A-3

Weaknesses:

- Weak profitability despite several years of restructuring efforts
- High sensitivity to overall economy and substantial volume decline in the first half of 2009
- Highly volatile raw material costs present difficulties for specialty chemicals business model

Rationale

The ratings on Switzerland-based specialty chemicals manufacturer Clariant AG reflects our view of the company's satisfactory business profile as a leading producer of specialty chemicals and its intermediate financial risk profile, according to our classifications. 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 as a result of a material sensitivity to economic cycles and raw material cost volatility. We view as a negative rating factor 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 nine months of 2009 suffered from a 20% year-on-year decline in volumes sold and a material underutilization of production assets to relieve working capital. The company therefore reported very weak profitability, demonstrated by an EBITDA margin of 6.7% before exceptional items. This compares with a reported EBITDA margin of 9.7% as of year-end 2008, which we observe 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. We note that lower raw material costs should also have supported profitability somewhat throughout 2009. However, we expect profitability in 2009 to have remained clearly below 2008 levels for the full year, although volumes could increase slightly in the coming quarters.

Key cash flow and capital-structure developments

Clariant's cash flow generation benefited in the first nine months of 2009 from a significant release of working-capital inflow of CHF535 million. 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: funds from operations (FFO)-to-debt for the 12 months ended Sept. 30, 2009, reached 18% compared with about 30% as of year-end 2008. Debt to EBITDA rose to 3.7x at the end of September compared with 2.5x as of year-end 2008. We believe Clariant's key credit metrics could improve in the coming quarters as a result of improving volumes and implemented restructuring programs.

Short-term credit factors

The short-term rating is 'A-3'. Clariant's liquidity position is adequate. The group had CHF995 million in cash and cash equivalents as of Sept. 30, 2009. This contrasts to CHF177 million of debt due until the end of 2010. The short-term debt obligations largely comprise financial liabilities at subsidiaries, which we believe Clariant will be able to roll over. In addition, the company has renegotiated its syndicated back-stop facility, reducing it to CHF400 million. This was fully undrawn as of Sept. 30, 2009. The facility is subject to financial covenants, which offered Clariant adequate headroom as of Sept. 30, 2009. Clariant's debt-maturity profile is good, in our view, with the next significant maturity due in 2011--a "Schuldschein" (promissory note) of €100 million.

We expect Clariant's cash flow generation to be strongly positive in 2009 as a result of a material reduction in working capital and capital expenditures, which should support the company's liquidity. However, substantial restructuring costs and most likely slightly increasing working capital might be negative for liquidity in 2010.

Outlook

The negative outlook reflects our view 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 from 2010.

We consider an outlook revision to stable currently unlikely, owing to the difficult economic environment. However, an outlook revision could occur if the company managed to materially improve its profitability, achieve a significant improvement in volumes sold in the course of 2010, and if its profitability can sustainably benefit from the lower cost base after the initiated restructuring.

Business Description

Clariant is a leading producer of specialty chemicals, having achieved sales of CHF6.6 billion for the 12 months ended Sept. 30, 2009. Its key products include pigments and additives for coatings used in the automotive industry, colored plastics used to produce coverings for a large variety of household products, and surfactants for use in home and personal-care products such as detergents, creams, and soaps.

Clariant operates about 30 major production plants worldwide and markets its products in more than 100 countries. The group generated 44% of its sales in Europe (of which 2% in Switzerland), 29% in the Americas, and 26% in Asia-Pacific in the first nine months of 2009.

Clariant currently reports its results in four business divisions (see charts 1 and 2). However, it will move toward a

new structure with 10 business units as of January 2010. Currently, the four business divisions are:

- **Textile, leather, and paper chemicals:** This division produces dyes and chemicals for the textile, leather, and paper industries, with textiles representing about 60% of sales. Globally, Clariant is the top producer of textile chemicals and is ranked No. 3 in textile dyes. In leather chemicals, Clariant is the global market leader. In particular, it is No. 1 in the automotive leather segment, which, however is weakening as auto production slows. From January 2010, Clariant will split this division into four business units called Paper Specialties, Leather Services, Textile Chemicals, and Emulsions.
- **Pigments and additives:** This division offers a broad range of products for coatings, plastics, and printing inks. Demand growth is linked to GDP development and therefore expected to be weak in coming quarters. Additives and pigments provide coloring features and specific properties, such as heat resistance. The main competitors in this segment include BASF SE (A+/Negative/A-1), and Chemtura Corp. From January 2010, Clariant will report this division under two business units named Pigments and Additives.
- **Masterbatches:** Clariant is the largest producer of masterbatches and benefits from currently strong markets for plastics. This division produces plastic compounds with a high concentration of color pigments. Its products are sold to plastic processors, which add the compounds at rates of between 1% and 5% to give simple plastics special coloring and other properties. Customer industries mainly include packaging and consumer applications. From January 2010, Clariant will continue to report Masterbatches as a separate business unit.
- **Functional chemicals:** This business segment offers a broad range of chemical solutions, from surfactants for detergents and personal-care industries to products for the oil-service industry. From January 2010, Clariant will split up the division into three business units named Industrial & Consumer Specialties, Detergents & Intermediates, and Oil & Mining Services.

Chart 1

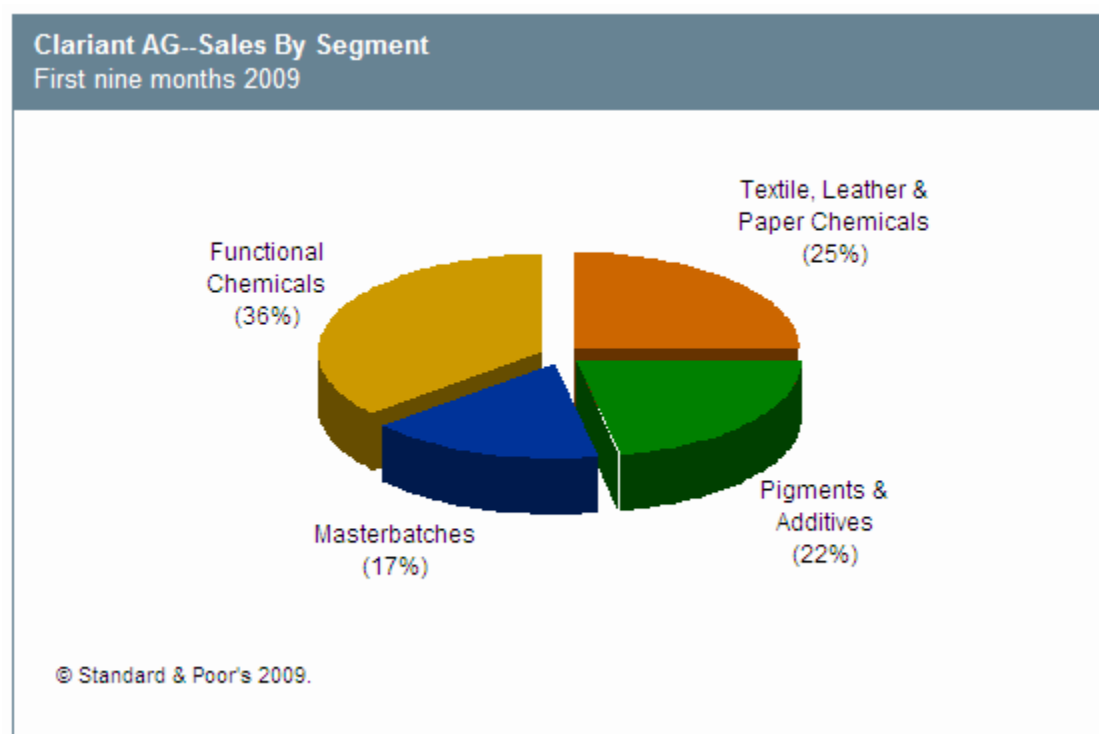
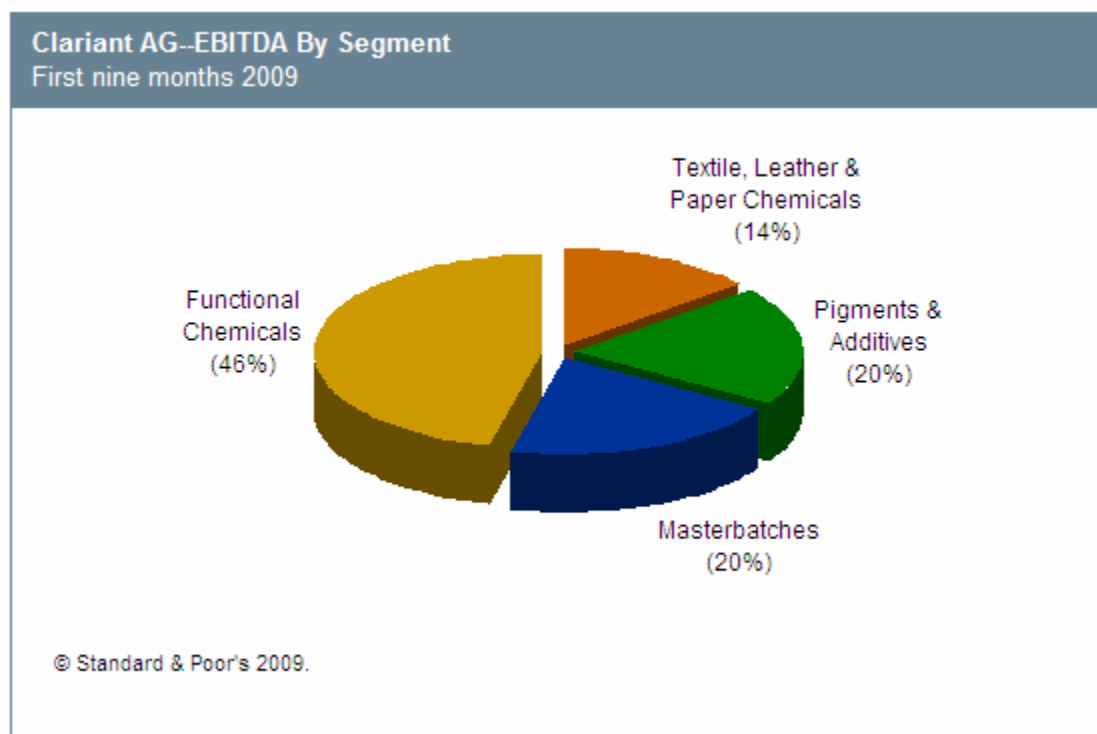


Chart 2



Business Risk Profile: Benefits From Good Diversification By Product, Region, And End Markets

Clariant is among the leading producers of specialty chemicals. In contrast to base chemical producers, its product portfolio has more than 20,000 products, reflecting strong diversification by product and end market. The company produces in relatively small quantities, and the capital intensity of production is lower than that of base chemicals.

Although production processes in the specialty chemicals industry are often relatively simple, the molecules are more complex. Products are mainly customized and produced for specific needs, making them less vulnerable to becoming commodities than is the case for base chemicals. They are also less vulnerable to pure price-based competition, although Clariant estimates that about 40% of its products are differentiated by price and therefore do not fulfill all the characteristics of specialty products. The lifecycle of specialty chemicals is significantly lower than that of base chemicals, often between two and four years, which puts pressure on the company to develop new products. Because it is difficult to impose price increases during a product's lifetime, new chemicals are the main conduit for price increases and profitability improvements.

Because the specialty chemicals industry serves a wide variety of end markets, there are various cycles within the sector, and these differ from the petrochemicals cycle (see chart 3 for Clariant's sales by end markets in 2008). Demand and supply imbalances are not as severe for specialty chemicals producers as for the base chemicals industry. In addition, batch processes in specialty chemicals production do not permit the high-capacity utilization of assets that continuous processes in base chemicals allow. Specialty chemicals producers face higher transaction exposure on currencies than base chemical producers because their products may be transported over long distances.

Clariant's production costs are largely denominated in euros and exceed its euro-denominated sales. On the other hand, the company has higher sales in U.S. dollars compared with its dollar-denominated production costs. This makes the company exposed to currency transaction risk. Any weakening of the dollar will therefore be negative for the company's profitability.

Chart 3



Although operating margins or return on capital in specialty chemicals are not higher than those of base or intermediate chemicals over a cycle, they are somewhat less volatile. Specialty chemical producers like Clariant benefit from good diversification by end markets and substantial penetration in the home and personal-care markets. However, in the majority of its end markets, the company remains very sensitive to economic growth. Clariant experienced a substantial decline in selling volumes of 20% in the first nine months of 2009.

The level of a specialty chemical business' sensitivity to economic conditions varies according to the end markets it serves. Clariant's large exposure to the home and personal-care markets in the Functional Chemicals division helped in 2009 to contain its sales decline at negative 12%, while more industrial-orientated end markets in its pigments and additives business suffered a sales decline negative 29% in the first nine months of 2009. We consider that Clariant's sales could improve slightly over the coming quarters in line with our expectations of moderate growth for the major economies, but we believe overall capacity utilization will remain modest.

Specialty chemical producers operate further downstream than the average chemicals manufacturer. Therefore, raw material costs account for about 50%-60% of total costs, which is significantly less than for commodity chemicals, for which up to 80% of total costs often relate to raw materials. Raw material costs have declined materially in 2009, but the higher oil price will most likely result in an increasing raw material cost trend over the coming quarters. Depending on Clariant's pricing power, this could negatively affect the company's earnings improvement

achieved by its restructuring activities.

Profitability: Further weakened in 2009 due to weak economic conditions

Clariant's profitability remains weak despite several years of restructuring efforts. It has further weakened in 2009 as a result of the sluggish business environment. In addition, intense competition over the past few years has not given Clariant the pricing power it needs to deal with highly volatile raw material costs. Clariant has therefore announced further significant restructuring programs to reduce its production capacity across the globe and reduce the complexity of its portfolio. The company's unadjusted EBITDA margin was 6.7% for the first nine months of 2009, compared with 10.7% in 2008 and 10.2% as of year-end 2008. This is clearly below the average of our rated chemical producers in the EMEA region, which reported on average of 14.4% at year-end 2008. What's more, Clariant's return on capital is very weak, in our view, at 6.6% as of year-end 2008, and it was negative for the 12 months ended Sept. 30, 2009. Nevertheless, we expect profitability to improve in the years ahead thanks to the company's significant restructuring efforts and somewhat lower raw material costs.

Financial Risk Profile: Weakened By Restructuring And Poor Profitability In Past Years

Clariant's financial risk profile has weakened in our observation as a result of materially weakening profitability and sales over the past years. However, the company has recently managed to reduce its absolute debt levels and to make in our view important improvements in its capital structure. As of Sept. 30, 2009, the company had about CHF400 million less debt than at year-end 2008. Credit protection ratios are clearly below levels required for the intermediate category for the time being, but we believe it likely that they will be able to reach adequate levels again from 2010. In particular, free operating cash flow generation was exceptionally strong in the past nine months, benefiting from a substantial reduction in working capital.

Accounting

Clariant has reported under International Financial Reporting Standards since January 1995. Standard & Poor's Ratings Services made the following key adjustments to the company's reported debt figures for fiscal year ended Dec. 31, 2008:

- We added a tax-adjusted pension deficit of CHF497 million. Clariant had CHF1,765 million in pension obligations and CHF80 million in other postretirement obligations. The market value of plan assets was about CHF1,294 million as of year-end 2008;
- We added operating leases with a net present value of CHF145.7 million;
- We added guarantees of CHF77 million at year-end 2008.
- We deducted surplus cash of CHF206 million, adjusted for operating cash needs that we estimated at about CHF150 million.

For 2009, we believe that material restructuring charges could significantly distort our calculation of credit protection ratios. We will review in details the restructuring charges and may adjust FFO and EBITDA in 2009.

Table 1

Reconciliation Of Clariant AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. CHF)*

--Fiscal year ended Dec. 31, 2008--

Clariant AG reported amounts									
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	1,565.0	1,937.0	794.0	794.0	229.0	85.0	391.0	391.0	270.0
Standard & Poor's adjustments									
Operating leases	145.7	--	59.5	9.6	9.6	9.6	49.9	49.9	22.2
Postretirement benefit obligations	497.0	(134.4)	13.0	13.0	13.0	5.0	7.7	7.7	--
Additional items included in debt	77.0	--	--	--	--	--	--	--	--
Surplus cash and near cash investments	(206.0)	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	3.0	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	14.0	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	132.0	--
Minority interests	--	50.0	--	--	--	--	--	--	--
Other	--	--	--	--	--	--	41.0	41.0	--
Total adjustments	513.7	(84.4)	72.5	25.6	36.6	14.6	98.6	230.6	22.2
Standard & Poor's adjusted amounts									
	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	2,078.7	1,852.6	866.5	819.6	265.6	99.6	489.6	621.6	292.2

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations).

Corporate governance/Risk tolerance/Financial policies

We understand that Clariant is committed to an "intermediate" financial policy, according to our classifications, and is aiming to continue its deleveraging process. We believe dividend payouts are likely to remain very modest in the coming years as a result of the company's earnings-based philosophy, which is to payout in the range of 25%-35% of net operating profit before exceptional items in the coming years. Clariant's senior management has undergone material changes in the past years but, so far, there have been no material changes to the company's financial policy and we expect the new senior management team to remain committed to the company's

intermediate financial policy.

The company has a clearly defined and publicly stated corporate governance. While it is untypical that the CEO is also part of the board of directors, this remains a typical feature of supervisory boards in Switzerland.

Cash flow adequacy: Hit by weak sales but helped by lower working capital

Clariant's cash flow protection ratios have been hit heavily in 2009 by weak sales volumes. FFO to debt at 18.3% for the 12 months to Sept. 30, 2009, was therefore clearly below the 29.9% at year-end 2008. However, the company's free operating cash flow to debt was exceptionally strong in the past nine months in 2009, and reached 47%. This reflects the material reduction in working capital (CHF535 million in the first nine months of 2009) as well as substantially lower capital expenditures. In the nine months to Sept. 30, 2009, Clariant spent about CHF120 million and we therefore expect capital expenditures for the full year to reach only about 50% of historical levels. However, significant cash outlays for restructuring in 2009 and 2010 will negatively affect the company's discretionary cash flow generation. We expect Clariant's cash flow protection ratios to improve in 2010 and reach levels adequate for the intermediate category. This includes FFO to debt of about 30%.

Capital structure/Asset protection: Affected by large restructuring charges

Clariant's capital structure remained stable in the first nine months of 2009. Debt to capital reached about 47%, which is on the low end of the intermediate category. Debt to EBITDA weakened materially to 3.7x for the 12 months ended Sept. 30, 2009, and has been heavily affected by large restructuring charges and weak capacity utilization. We expect a material improvement over the coming 12 months, largely stemming from an improved capacity utilization and first benefits from the initiated restructuring program.

Peer Comparison And Financial Statistics Tables

Table 2

Clariant AG -- Peer Comparison*				
Industry Sector: Chemical Cos				
	Clariant AG	LANXESS AG	Evonik Degussa GmbH	Rhodia S.A.
Corporate credit rating [¶]	BBB-/Negative/A-3	BBB/Stable/A-2	BB/Stable/B	BB-/Stable/B
(Mil. €) --Fiscal year ended Dec. 31, 2008--				
Revenues	5,423.7	6,576.0	15,873.0	5,313.0
Net income from cont. oper.	(24.2)	171.0	168.0	73.0
Funds from operations (FFO)	417.7	484.7	1,120.4	431.2
Capital expenditures	196.3	361.3	1,165.0	297.8
Free operating cash flow	132.7	149.5	(793.6)	77.4
Debt	1,396.9	1,205.5	7,880.3	2,358.9
Equity	1,244.9	1,396.5	5,188.8	(397.6)
Adjusted ratios				
Oper. income (bef. D&A)/revenues (%)	10.7	11.0	11.6	12.2
EBIT interest coverage (x)	2.7	6.3	1.5	1.8
EBITDA interest coverage (x)	8.2	9.4	3.4	3.3
Return on capital (%)	6.1	18.2	5.8	16.6
FFO/debt (%)	29.9	40.2	14.2	18.3

Table 2

Clariant AG -- Peer Comparison* (cont.)				
Free operating cash flow/debt (%)	9.5	12.4	(10.1)	3.3
Debt/EBITDA (x)	2.5	1.7	4.4	3.7
Total debt/debt plus equity (%)	52.9	46.3	60.3	120.3

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. ¶As of Dec. 16, 2009. N.M.--Not meaningful.

Table 3

Clariant AG -- Financial Summary*					
Industry Sector: Chemical Cos					
--Fiscal year ended Dec. 31--					
(Mil. CHF)	2008	2007	2006	2005	2004
Rating history	BBB-/Stable/A-3	BBB/Negative/A-3	BBB/Stable/A-2	BBB/Stable/A-2	-/-/-
Revenues	8,071.0	8,533.0	8,100.0	8,181.0	8,530.0
Net income from continuing operations	(36.0)	101.0	124.0	184.0	152.0
Funds from operations (FFO)	621.6	642.7	603.2	572.3	714.5
Capital expenditures	292.2	351.6	358.0	415.3	289.0
Free operating cash flow	197.5	279.1	82.2	92.9	775.5
Debt	2,078.7	2,119.8	2,407.8	2,504.3	2,447.9
Equity	1,852.6	2,397.2	2,382.6	2,452.6	2,200.9
Adjusted ratios					
Oper. income (bef. D&A)/revenues (%)	10.7	10.3	11.8	10.0	11.4
EBIT interest coverage (x)	2.7	2.8	3.4	3.2	2.0
EBITDA interest coverage (x)	8.2	7.0	6.9	4.7	4.4
Return on capital (%)	6.1	6.7	8.6	9.9	7.5
FFO/debt (%)	29.9	30.3	25.1	22.9	29.2
Free operating cash flow/debt (%)	9.5	13.2	3.4	3.7	31.7
Debt/EBITDA (x)	2.5	2.6	2.7	3.3	2.7
Debt/debt and equity (%)	52.9	46.9	50.3	50.5	52.7

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. CHF--Swiss franc.

Ratings Detail (As Of December 16, 2009)*

Clariant AG

Corporate Credit Rating	BBB-/Negative/A-3
Senior Unsecured (3 Issues)	BBB-

Corporate Credit Ratings History

28-Jan-2009	BBB-/Negative/A-3
14-Mar-2008	BBB-/Stable/A-3
23-Aug-2007	BBB/Negative/A-3
15-Nov-2005	BBB/Stable/A-2

Business Risk Profile

Satisfactory

Financial Risk Profile

Intermediate

Ratings Detail (As Of December 16, 2009)***(cont.)**

Debt Maturities

Sept. 30, 2009:
2009: CHF107 mil.
2010: CHF70 mil.
2011: CHF156 mil.
2012: CHF249 mil.
2013: CHF889 mil.
>2014: CHF275 mil.

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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