

### Research Update:

## Rockwood Specialties Group Inc. Upgraded To 'BB-', Outlook Stable; Recovery Ratings Revised

#### Primary Credit Analyst:

Paul Kurias, New York (1) 212-438-3486;paul\_kurias@standardandpoors.com

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## Research Update:

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## Overview

- Operating performance at U.S.-based specialty chemicals producer Rockwood Specialties Group Inc. has improved in 2010. Our expectation is that the improvement is sustainable.
- We are raising our ratings on the company, including the corporate credit rating to 'BB-' from 'B+'.
- We are revising the recovery rating on the company's senior secured debt to '1' from '2' to reflect improved recovery prospects following the recent paydown of senior secured debt. Our recovery rating on the subordinated debt remains unchanged at '6'.
- The stable outlook reflects our expectation that Rockwood will maintain credit measures in an appropriate range for the ratings during the next year.

## Rating Action

On July 29, 2010, Standard & Poor's Ratings Services raised its ratings on Rockwood Specialties Group Inc., including its corporate credit rating to 'BB-' from 'B+'. The outlook is stable.

At the same time, we raised our rating on Rockwood's senior secured debt, consisting of a revolving credit facility and term loans, to 'BB+' from 'BB-'. The 'BB+' rating is two notches above the corporate credit rating. We also revised the recovery rating on the senior secured debt to '1', indicating our expectation for very high recovery (90%-100%) in the event of a payment default, from '2'. In addition, we raised the rating on the company's subordinated notes to 'B' (two notches below the corporate credit rating) from 'B-'. The '6' recovery rating on the subordinated notes, indicating negligible recovery (0%-10%) in the event of a payment default, remains unchanged.

## Rationale

Our rating action reflects improvements to the company's leverage-related credit metrics, due to higher earnings and cash flow in 2010, and lower debt levels relative to a year ago. Our expectation is that improved demand trends and the continuing benefits from a cost reduction program are sustainable and will contribute to a further gradual strengthening of credit measures over the next year and beyond. Rockwood has reported higher sales volumes as demand in the company's cyclical end markets has improved, following sharp deteriorations in 2009. As a result, the company's quarterly revenues for second quarter 2010 increased 20% relative to second quarter 2009. Operating

margins (before depreciation and amortization) in 2010 have reverted to historical levels of approximately 20%, an improvement over the 18% achieved through most of 2009. These improvements, combined with a meaningful paydown of debt, have lifted the ratio of funds from operations (FFO) to total debt to about 16% as of March 31, 2010, from trough levels of 9% in 2009. The ratio as of March 31, 2010, is pro forma for a July 29, 2010, \$200 million debt repayment of senior secured debt. This debt paydown follows approximately \$300 million of debt reduction in 2009.

The ratings on Princeton, N.J.-based Rockwood reflect the company's aggressive financial profile and a satisfactory business risk profile. Leverage has improved and is at levels appropriate for the rating. The ratio of FFO to total debt is within the 12% to 20% band that we expect at the current rating. We expect that the company will at least maintain its leverage-related credit metrics at current levels, though it is also likely that modest improvements could occur over the next several quarters, even after accounting for modest debt-funded acquisitions and working capital increases. We believe management will continue to be prudent in its capital spending plans and in any potential acquisitions or shareholder rewards, thereby maintaining a financial policy that supports the current ratings.

Rockwood has an attractive portfolio of specialty chemical businesses. During the past few years, the company has adjusted its business mix via acquisitions, divestitures, and the formation of joint ventures. Rockwood's five major business lines consist of:

- Specialty chemicals (primarily surface treatment chemicals and lithium);
- Performance additives (color pigments, timber treatment chemicals, and clay-based additives);
- Titanium dioxide (primarily for textile fibers);
- Ceramics (used in medical applications, electronics, and cutting tools);  
and
- Specialty compounds (thermoplastic materials primarily for wire and cable).

Favorable market positions in key specialty chemical products characterize the company's business profile. Rockwood's proprietary manufacturing technology and longstanding service-intensive customer relationships have contributed to its leadership positions, which in turn have contributed to the company's healthy operating margins. The company also benefits from diversity in its operations, including a broad range of applications catering to several end user industries such as metals, automobile, construction, and life sciences. About 60% of revenues are derived from overseas markets, most notably Germany. The company's diverse and largely inorganic raw materials have insulated its margins somewhat from volatile hydrocarbon prices.

Growth prospects for the company's segments are reasonable but remain somewhat linked to economic growth, and are vulnerable to cyclical demand downturns. A notable exception is the potential for growth in the company's lithium business, in which the company is a clear market leader. Growth in this segment has the potential to be well above GDP rates and possibly insulated

from economic cycles, dependent instead on the pace of adoption of environment-friendly battery or electric-powered vehicles by the automobile industry. However, the rate and timing of this potentially extraordinary growth is uncertain at this point, and notwithstanding these strengths, overall volumes and earnings remain somewhat vulnerable to demand compression in Rockwood's cyclical end-user industries.

## **Liquidity**

Liquidity is adequate. As of June 30, 2010, the company had about \$376 million in cash and no utilization under its \$250 million revolving credit facility. As of July 30, we expect the revolving credit facility to shrink to \$180 million following the maturity of a \$70 million tranche of the facility. The debt maturity profile is manageable, though the company has a large amount of about \$1.7 billion maturing in 2014. We expect management will be proactive in managing its maturity profile. Capital spending (adjusted for operating leases) is expected to revert to levels between \$200 million and \$250 million following a decline to levels below \$200 million during the recent recession.

Cushions under the company's covenants are comfortable. We expect cushions to remain comfortable given our estimation that 12-month EBITDA will at least remain at current levels of more than \$600 million, and our belief that management will continue to remain prudent with respect to the use of debt. Our rating factors in modest acquisitions. We do not expect working capital swings to be pronounced, especially given the absence of exposure to volatile hydrocarbon inputs. Free cash flow generation is expected to be healthy.

## **Recovery analysis**

For the complete recovery analysis, see our recovery report on Rockwood to be published on RatingsDirect following this report.

## **Outlook**

The stable outlook reflects our expectation that credit measures will remain appropriate for the ratings. We expect that the company will continue to benefit from its cost cutting program, which is under implementation, and from an ongoing revival in demand within its end markets. We assume a steady growth in revenues over the next year and operating margins at current levels of 20%. Our ratings do not factor in meaningful acquisitions or shareholder rewards.

We could raise our ratings if operating performance improves faster than expected or if the company continues to pay down meaningful amounts of debt so that the ratio of FFO to total debt improves and is maintained near 20% on a sustainable basis. A faster-than-expected improvement to operating performance could result from revenue growth well above the mid-single-digit level we assume and operating margins in excess of 20%.

We could lower ratings if revenue growth unexpectedly stalls, or if margins

revert to recession levels in the high teens so that FFO to total debt declines below 12%, with no prospects for improvement.

## Related Criteria And Research

- 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

### Upgraded

	To	From
Rockwood Specialties Group Inc. Corporate Credit Rating	BB-/Stable/--	B+/Stable/--

### Upgraded; Recovery Ratings Revised

Rockwood Specialties Group Inc. Senior Secured Recovery Rating	BB+ 1	BB- 2
Subordinated Recovery Rating	B 6	B- 6

Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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