

Rockwood Specialties Outlook Revised To Positive On Improved Financials; 'B+' Rating Affirmed

Credit Rating:

B+/Positive/—

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Rationale

On July 5, 2006, Standard & Poor's Ratings Services revised its outlook on Rockwood Specialties Group Inc. to positive from stable. At the same time, we affirmed all of our ratings on the company, including the 'B+' corporate credit rating (see list below).

The outlook revision reflects our expectation that Rockwood's financial profile should continue to strengthen, primarily through gradual earnings improvement, to a level that would warrant a slightly higher rating during the next 18 to 24 months. Earnings are expected to trend upward because of favorable market prospects, moderate organic sales growth, and close attention to operating costs. However, the company's high debt leverage and our expectation that it will continue to pursue modest-size acquisitions will likely limit the amount of cash available for debt reduction.

The ratings on Princeton, N.J.-based Rockwood reflect a highly leveraged financial profile, which overshadows an attractive portfolio of specialty chemical businesses with annual sales of about \$3 billion.

Operations are organized into the following seven business areas of which management considers the first four to be core:

- Specialty chemicals (lithium, fine chemicals, and other surface treatment chemicals);
- Performance additives (clay-based additives, iron oxide pigments, water treatment chemicals, and timber treatment chemicals);

- Titanium dioxide pigments (functional additives, titanium dioxide chemicals, and paper and water treatment chemicals);
- Advanced ceramics (ceramic materials used in medical, electronics, and other applications);
- Groupe Novasep (synthesis of pharmaceutical intermediates);
- Specialty compounds (specialty compounds for wire and cable); and
- Electronics (electronic chemicals and photomasks).

Rockwood benefits from well-established business positions, with a significant portion of sales in products with leading niche market shares. The firm's diverse end markets, product range, and technology platforms lend stability to earnings and cash flow generation, tempering the cyclical swings in larger end markets, such as electronics and construction. A focus on technology-based products underpins value-added pricing. In addition, favorable long-term business fundamentals in key product lines should aid cash flow generation. The company's credit quality is supported by a broad customer base and meaningful geographic diversity, with about two-thirds of sales outside the U.S. A global network of manufacturing facilities provides a platform to expand product sales internationally.

Rockwood's raw material base is broad and mostly inorganic, which significantly limits exposure to volatility in petrochemical feedstocks (although margins in its wood treatment business are currently being squeezed by high copper costs). In addition, operations are generally not energy intensive. Although R&D spending as a percentage of sales is less than that of other specialty chemical companies and capital expenditures are somewhat higher, value-added pricing, competitive cost positions, and diversity of products and geographies support better-than-average operating margins (before depreciation and amortization) that should average in the upper teens percentage area. However, foreign currency and interest rate movements can affect profitability. Management is likely to manage the portfolio of businesses to concentrate on more favorable positions. For example, in March 2006, Rockwood sold Rohner AG, which had been a weak performer.

In August 2005, Rockwood's parent, Rockwood Holdings Inc., completed a partial IPO, but continues to be controlled by affiliates of Kohlberg Kravis Roberts & Co. L.P. Proceeds of about \$470 million were used to reduce debt and redeem preferred stock. Even so, Rockwood remains highly leveraged. At March 31, 2006, total debt (including capitalized operating leases and unfunded postretirement obligations on a tax-effected basis) was about \$3.1 billion. Total adjusted debt to EBITDA was 5.4x, with funds from operations to adjusted total debt of just above 11%, and EBITDA interest coverage of 2.9x.

Liquidity

At May 12, 2006, Rockwood had about \$150 million of availability under a \$250 million senior secured revolving credit facility maturing in 2010 and cash of about \$40 million. The company is expected to remain in compliance with financial covenants under the facility which included maximum total leverage of 6.5x and minimum interest coverage of 1.75x at March 31, 2006.

Liquidity should remain adequate to meet foreseeable operating and financing requirements. These include annual capital expenditures of about \$200 million, interest expense of roughly \$200 million per year, debt maturities averaging about \$100 million during each of the next few years, and working capital needs. Outlays with regard to other liabilities, including environmental and postretirement benefit obligations, appear

manageable. A diverse product portfolio provides opportunities for the monetization of assets, thereby aiding financial flexibility and providing some additional capacity for debt reduction.

Recovery analysis

The bank credit facilities consist of a \$250 million revolving credit facility maturing in 2010 and term loans with a remaining balance of about \$1.7 billion that mature in 2011 and 2012. The credit facilities are rated 'B+', the same as the corporate credit rating, with a '3' recovery rating. These ratings indicate our expectation for meaningful (50% to 80%) recovery of principal in a payment default scenario. See Standard & Poor's research report on Rockwood dated July 13, 2005, for the complete recovery analysis.

Outlook

The outlook is positive. Leading shares in attractive and diverse end markets, solid profitability, and favorable business and economic prospects should permit the company to continue to gradually strengthen credit measures. We could raise the ratings by one notch within the next 18 to 24 months if the ratio of funds from operations to adjusted total debt approaches 15% and operating prospects remain favorable at that time. Ratings could also be raised if the company is able to reduce debt leverage through asset sales. Conversely, we could revise the outlook to stable or negative or lower the ratings if business conditions deteriorate unexpectedly or the company undertakes larger-than-expected, debt-financed acquisitions.

Ratings List

Outlook Revised	To	From
Rockwood Specialties Group Inc.		
Corporate credit rating	B+/Positive/—	B+/Stable/—
Ratings Affirmed		
Senior secured bank loan	B+	
Recovery rating	3	
Subordinated debt	B-	

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