



Rhodia

Re-Energized and Ready for the Next Phase

Rhodia (Paris) is in the final stages of a recovery program—a strict regime of portfolio rationalization, profitability enhancement, and refinancing—that rescued the company from financial meltdown. Rhodia almost crumbled four years ago under the legacy of profligate spending on acquisitions at the start of the decade. The company faced a severe liquidity crisis, having racked up massive debts and failing to improve the performance of the acquired assets, many of which were delivering disap-

pointing returns. Today, its transformation almost complete, Rhodia is on a firm financial footing. The company has a downsized but profitable portfolio generating sales of more than €5 billion/year (\$7.8 billion) with leading positions in markets such as silicas, nylon-6,6, rare earths, and surfactants, and it is equipped for expansion, particularly in emerging markets such as Asia/Pacific. Rhodia is currently grappling with the worldwide spike in raw material costs but is confident it can claw back margins this year by raising prices.

“We have achieved a lot,” says Rhodia chairman and CEO Jean-Pierre Clamadieu. “We have been able to transform and change Rhodia profoundly.”

Clamadieu took charge of Rhodia in October 2003, a year it reported net losses of more than €1.3 billion and an Ebitda margin of 6.7%, and its €3.2-billion net debt was almost nine times Ebitda. He had 10 years’ previous experience within the company’s businesses, starting when they formed part of Rhône-Poulenc. “I was convinced that Rhodia had some key success factors—strong market positions and good management teams,” Clamadieu says. “It was frustrating that, despite these elements, the company was going to the wall. There was a clear lack of trust, internally and externally,” he says.

Nine months of “crisis management” followed, during which Rhodia convinced its banks to extend the financing necessary to implement the company’s recovery program, Clamadieu says. The plan’s main financial objectives were a return to net profit, an Ebitda margin above 13%, and debts below 2.9 times Ebitda, in 2006. Rhodia duly hit those targets, including its first net profit since 2000, and has spent the period since 2006 completing its divestment program, securing its financial position further, and achieving additional cost reductions. “The key question was whether we could ride out the financial crisis in the first nine months,” Clamadieu says. “By mid-2004, we had clear road maps with a lot of boxes to be checked such as fixed cost reductions and divestments. Between mid-2004 and 2006 we checked boxes one after the other, which gave us a positive momentum. At the top level and more operational level of the company, and externally, people regained confidence in our ability to deliver.”

Rhodia has slimmed down its portfolio from 17 enterprises, to seven since 2004, and will soon reduce it to six. It divested its more cyclical businesses, raising overall proceeds of about €1.4 billion, and closed some operations. Rhodia’s biggest divestments were its food ingredients and specialty phosphate businesses in 2004, pharma custom synthesis in 2006, and silicones in 2007.

The six remaining enterprises are: Polyamide, the second-biggest producer of nylon-6,6 after Invista and a top-three producer of nylon engineering plastics and intermediates; Novocare, the world leader in mild amphoteric surfactants, phosphorus chemistry, and guar and derivatives; Silcea, the leading maker of high-performance silicas and rare earth-based products; Acetow,

the third-biggest supplier after Celanese and Eastman Chemical of cellulose acetate fibers for cigarette filters; Eco Services, the top U.S. supplier of sulfuric acid regeneration technology; and Energy Services, which optimizes energy supply for Rhodia and third parties, and manages the company's Carbon Emission Reduction Credits (CER).

The last major asset to be divested will be Rhodia's Organics enterprise, which the company is selling piecemeal. The biggest organics asset to be sold is the €300-million/year isocyanates business. Rhodia produces isocyanates at Pont-de-Claix, France partly for LyondellBasell Industries under a tolling arrangement, and at Freeport, TX. Rhodia and LyondellBasell agreed recently to sell their isocyanates businesses to Perstorp in a deal expected to close mid-year. The other organics businesses to be sold include trifluoroacetic acid and derivatives, and salicylic acid and derivatives, and have combined sales of about €270 million/year. They reported negative Ebitda of €11 million in 2007. Organics is gradually being shrunk through plant closures in France and the U.K. in 2007-08, and Rhodia will place the remaining operations into a separate business unit until they are divested. "We'll need to execute a significant number of small projects to exit this group of businesses," Clamadieu says. He expects the process to be completed by mid-2009.

Rhodia is keeping one organics business, diphenols, which it says is the biggest supplier for vanillin production and has sales also of about €270 million/year. Diphenols will be absorbed by the Silcea enterprise.

"We have achieved our goal, which is to have a portfolio of businesses with strong and sustainable leadership positions, which will allow us to grow," Clamadieu says. "In three years we have completely reshaped the portfolio, and today all of our global businesses are among the first three players."

Rhodia accompanied its divestments with a rigorous profitability improvement program that cut costs by simplifying the company's internal structures and raised prices. The company created global support functions such as finance, human resources, and purchasing, each with regional service platforms, to serve all of Rhodia's enterprises. Each enterprise previously had its own support functions. Rhodia achieved annualized fixed cost savings of almost €300 million in 2004-06, largely through centralizing support functions, Clamadieu says.

Rhodia says it had no option but to make pricing a key part of the profitability plan

because 2004-07 was a period of steadily rising raw material prices. "From mid-2004, we started to look very closely at pricing, to make sure that we could pass our raw material cost increases on to our customers," Clamadieu says. Rhodia's raw material and energy costs increased by €290 million in 2005-07 and the company passed on €387 million in price hikes to its customers. "Clearly we have been able to manage this raw materials situation," he adds.

The Rhodia management, meanwhile, fought to stabilize the company's financial position, rescheduling and restructuring debt, and issuing shares. The company completed its refinancing in May 2007 and, as a result, none of its debt will mature before 2013.

Asset sales and profitability improvements have enabled Rhodia to reduce its indebtedness dramatically. The company cut its net debt to just below twice Ebitda by the end of 2007, hitting a subsequent target, set in 2006, one year in advance.

Rhodia is almost unrecognizable from the highly leveraged company it was four years ago, analysts say. "At net debt/Ebitda of 1.9 times, Rhodia looks very much a 'normal' chemical company going into 2008, a

Rhodia, even during its toughest times, made a priority of investing in the sustainability of its operations, and these projects have started to deliver important financial rewards for the company. Rhodia started in the late 1990s to develop a technology to burn emissions of nitrous oxide (N₂O), a by-product of the company's adipic acid production. N₂O has a global warming impact 300 times that of carbon dioxide. The company installed the technology at its Chalampé, France plant in 1998 under a voluntary emission-reduction agreement with the French government. Clamadieu estimates that without the project, Chalampé would today account for about 8% of France's greenhouse gas emissions. "It is probably the largest single action plan to help France meet its Kyoto Protocol objectives," he says.

The N₂O abatement technology was also installed at Rhodia's adipic plants at Paulinia, Brazil and Onsan, Korea after the United Nations approved the plants' participation in its Clean Development Mechanism (CDM) scheme for industrial plants in emerging countries. The plants receive CERs under the scheme that Rhodia sells in international markets. Sales of CERs totaled €189 million last



huge turnaround since 2004," says Thomas Gilbert, an analyst at UBS (Zurich). He characterizes Rhodia's mid-term outlook as "solid with short-term volatility," due to rising raw material costs.

Rhodia's debt is "still high compared with other European chemical players, but about average compared with U.S. players," Clamadieu says. "The average cost of our debt today is in line with our peers and, on top of that, we have financial flexibility, which means we have the resources to execute significant steps in our profitable growth strategy."

year, adding €135 million to Rhodia's Ebitda. "Paulinia and Onsan are the two biggest CDM projects," Clamadieu says. "They make sense from a sustainable development standpoint and an economic standpoint. We took a proactive look at Kyoto and were among the first chemical companies to perceive there was an opportunity." Rhodia says its combined sales "driven by sustainable development priorities" are €1.5 billion/year.

Rhodia followed up the achievement of hitting its 2006 financial targets by strengthening its performance further last year.

Net profits more than doubled in 2007, to €129 million, enabling the company to generate free cash flow of €161 million. Ebitda grew from €683 million, to almost €800 million, securing an increase in Ebitda margins from 14.2%, to 15.7%, exceeding a target of more than 15% for 2008 one year in advance.

Rhodia says its 2007 margins were higher than those of other “diversified” companies it considers to be its peer group: Arkema, Ciba Specialty Chemicals, Clariant, DSM, and Lanxess. “Overall, we had a very good year in 2007,” Clamadieu says. Rhodia’s recovery, and the restoration of confidence among shareholders and investors, will be cemented this year by the company’s first dividend payment in five years.

The 2007 results do not reflect the recent acceleration in raw material costs, however. “What we started to see during the fourth quarter is a change in the speed at which raw materials have increased,” Clamadieu says. “It doesn’t show much on our 2007 results or even if you look closely at quarter four, but it will show in quarter one.” Oil, natural gas, and petrochemical price increases are well-

documented, but Rhodia also has faced steep hikes in the cost of raw materials such as sulfur, sulfuric acid, and nitric acid, “products that were below my radar screen because formerly they were not considered big issues in terms of price,” he says.

■ RAPID TRANSFORMATION*		
	2003	2007
Ebitda margin	6.7%	15.7%
Net profits	-€1.3 billion	€129 million
Free cash flow	-€51 million	€161 million
Financial leverage ¹	8.9x	1.9x

*Key figures for Rhodia in 2003 and 2007. 1) Net debt as a multiple of Ebitda. Source: Rhodia.

Rhodia’s response was to announce across-the board price hikes of 7%-15% last November for all of its products. However, it has taken time for Rhodia to push through the price increases, and the outcome was a temporary squeeze on margins in the first quarter. Rhodia expects its first-quarter raw materials bill to have increased by €80 million. “It takes time to make this adjustment,”

Clamadieu says. “The price increase impact will be less in the first quarter than the raw material cost increase.” Rhodia will provide more details when it announces its first-quarter results on May 7.

Clamadieu is confident that, after a time lag, price increases will catch up with, and overtake, raw material cost hikes. “I’m very confident that for the whole of 2008 we’ll be able to do more than compensate for raw material price increases and generate a higher Ebitda than in 2007,” he says. “But clearly it’s a big fight.”

Meanwhile, Rhodia is generating “solid” sales volumes, Clamadieu says. “I see many press reports about recession, but I don’t see it in our order books,” he says. “Our plants are running as well as they did last year.”

Clamadieu confirmed, when announcing Rhodia’s 2007 results, that the company’s Ebitda margins would be eroded in the first quarter of 2008. He also declined to give specific guidance on full-year margins because of the volatile raw material environment. His comments caused some analysts to downgrade the company’s stock. Rhodia’s share price

also fell 20% on February 28, the day of the announcement, and dropped to a 12-month low of €12.22/share in mid-March. It has since recovered to more than €13/share.

The stock market fall was an “overreaction,” Clamadiou says. “My comments came at a time when financial and equity markets were very volatile,” he says. “Our pricing power has been much stronger in the last three years than our peer group. We are all buying the same raw materials and facing the same types of challenge,” he adds. Rhodia’s raw material bill was equivalent to 40%-42% of sales in 2007, “absolutely in the ball park” for a diversified chemical firm, Clamadiou says.

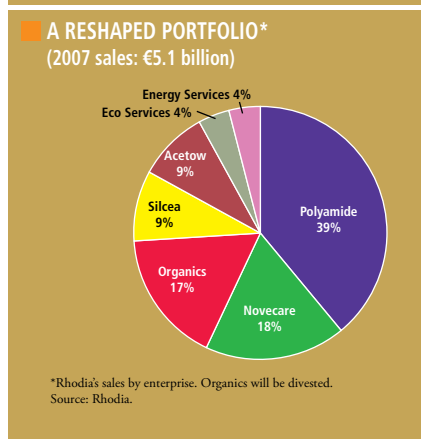
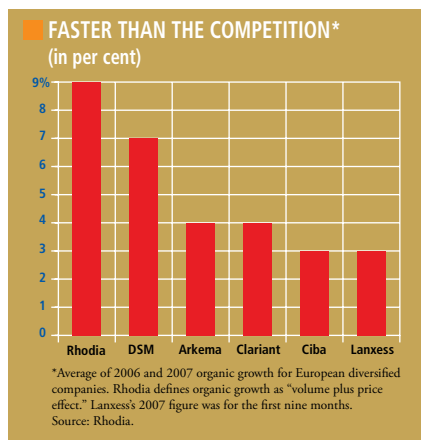
The weakening dollar is an additional challenge for Rhodia. About 42% of Rhodia’s sales are in emerging markets such as Asia and Latin America, a higher ratio than Arkema, Clariant, Ciba, and DSM, Clamadiou says. “This is a big plus because they are high-growth regions,” he says. “But Asia today is looked at as a dollar zone, and it’s true that we are probably a little bit more exposed than some of our competitors to the weak dollar.”

The competitiveness of Rhodia and of all other Europe-based companies is also “suffering” from the strength of the euro and from natural gas prices that are substantially higher in Europe than in North America, Clamadiou says. Foreign exchange movements added €82 million to Rhodia’s costs in 2007, he says. About €60 million were due to the dollar and €20 million to the real in Brazil, where Rhodia has 15% of its sales, the company says.

Analysts expect Rhodia to raise prices sufficiently to catch up with raw material costs, given the company’s recent track record. “Rhodia was able to fully offset additional costs in 2000-07 with a combination of price and volume increases,” says Morgan Stanley (London) analyst Michael Eastwood. “History would indicate that Rhodia has sufficient pricing power to offset the impact of raw material and currency costs. However, there is a lag of about one quarter,” Eastwood says. Morgan Stanley forecasts flat 2008 Ebitda of about €800 million and full-year Ebitda margins down slightly at 15.4%.

Rhodia, meanwhile, is looking beyond medium-term cost and price challenges toward its long-term future. Grassroots capital investments will be mainly in China and the rest of Asia, Clamadiou says. Rhodia has 10 Chinese production sites. Its main Asian production site outside China is at Onsan, and it has production in Japan. “Our future Asian investments are likely to be between China and Korea—mostly in China but in some cases it will make

sense to expand our Korean facilities versus building a new one in China,” Clamadiou says. Rhodia will open an R&D center at Shanghai later this year and start up a plant making highly dispersible silicas at Qingdao, China in 2009. Also, Novocare is due to commission a surfactants plant at Roha, India later this year.



Rhodia’s “next big project” will likely be a world-scale plant to manufacture the nylon intermediates adiponitrile and hexamethylenediamine for Asian markets, and the company is considering building the plant in the Mideast, Clamadiou says. “It’s not the Mideast market that attracts us,” he says. “It’s access to feedstock. We think that today conditions could be adequate for this type of project,” he adds. Rhodia expects to make a decision on the project by year-end and complete it in about 2013.

Rhodia’s restored balance sheet also enables the company to pursue acquisitions. “Having completed our refinancing, we are not at all subject to the current stresses or crises in the debt market,” Clamadiou says. The company has about €430 million on its balance sheet and €600 million of undrawn credit lines. “We could consider an acquisition costing multi-hundreds of millions of euros,” he says. “For our current strategy, which is to look at add-on,

focused acquisitions, financial resources are not a limiting factor.”

Acquisitions will be “pragmatic” and “opportunistic,” exemplified by Rhodia’s €15-million acquisition last year of W.R. Grace’s alumina washcoat business, which makes components for automotive emission-control catalysts. The asset complements Rhodia’s rare earth-based components for automotive emission-control systems.

Polyamide and Novocare are the Rhodia enterprises earmarked for rapid development. “They are significant growth platforms,” Clamadiou says. “We see quite a number of opportunities to grow these businesses by internal growth as in Polyamide or through a combination of organic growth and external growth in Novocare’s case.” Novocare operates in a fragmented market with “acquisition opportunities of various size and shape” but nylon is consolidated with relatively few players, he says.

Silcea and Energy Services form “a group of two businesses that are a little bit smaller in terms of future potential,” Clamadiou says. Acetow and Eco Services “are not seen as growth providers but more cash providers to the group,” he says.

Acetow is the only Rhodia enterprise for which cash flow return on investment does not exceed weighted average cost of capital, a key financial target for the company. The business is suffering particularly from the dollar’s slide because Rhodia’s two main competitors are U.S. based, as are many of the big manufacturers of cigarettes, and most of Acetow’s production is in Europe, Clamadiou says. “The business has heavy capital requirements so you need a high level of profitability,” he says. Rhodia is working to reduce Acetow’s fixed cost base and launched a program last year to cut 129 jobs in the business, 15% of its total. “We don’t plan to divest Acetow but we want it to go back to the profitability level it used to enjoy in a more favorable foreign exchange situation,” Clamadiou says.

Rhodia intends eventually to boost its presence in North America, which accounts for just 17% of sales. Only Novocare and Eco Services have significant positions in the North American market. “For a chemical company that has an ambition to be global, it’s a little bit too small,” Clamadiou says. “There are opportunities for us to grow our position in the U.S. and make sure that we have a global footprint, but it’s probably too soon. Our focus today is much more on high-growth regions such as Asia,” he says.

—IAN YOUNG *in Paris*