

Rockwood Holdings, Inc.  
Form 10-Q  
November 07, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

- x** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

Or

- o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-32609

**Rockwood Holdings, Inc.**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**52-2277366**  
(I.R.S. Employer  
Identification No.)

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**100 Overlook Center, Princeton, New Jersey 08540**

(Address of principal executive offices) (Zip Code)

**(609) 514-0300**

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of November 3, 2008, there were 74,058,417 outstanding shares of common stock, par value \$0.01 per share, of the Registrant.

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited).

## ROCKWOOD HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions, except per share amounts;

shares in thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net sales	\$ 880.8	\$ 763.1	\$ 2,647.8	\$ 2,281.1
Cost of products sold	623.3	525.8	1,834.5	1,549.2
Gross profit	257.5	237.3	813.3	731.9
Selling, general and administrative expenses	170.3	148.8	512.7	441.7
Restructuring charges, net	3.4	2.9	5.7	8.9
Gain on sale of assets and other	(2.7)	(0.1)	(1.8)	(5.3)
Operating income	86.5	85.7	296.7	286.6
Other income (expenses):				
Interest expense (a)	(56.3)	(57.0)	(139.7)	(158.6)
Interest income	0.6	1.7	4.2	10.1
Loss on early extinguishment of debt				(18.6)
Refinancing expenses				(0.9)
Foreign exchange (loss) gain, net	(26.5)	7.8	(12.2)	11.3
Other, net	0.2	(0.1)	0.7	(0.1)
Other expenses, net	(82.0)	(47.6)	(147.0)	(156.8)
Income from continuing operations before taxes and minority interest	4.5	38.1	149.7	129.8
Income tax provision	10.3	16.1	50.6	56.8
(Loss) income from continuing operations before minority interest	(5.8)	22.0	99.1	73.0
Minority interest in continuing operations, net of tax	1.0	(2.8)	0.4	(6.2)
Net (loss) income from continuing operations	(4.8)	19.2	99.5	66.8
Income from discontinued operations, net of tax	1.5	5.5	2.9	15.6
Gain on sale of discontinued operations, net of tax				115.7
Minority interest in discontinued operations, net of tax				(0.1)
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
Basic (loss) earnings per share:				
(Loss) earnings from continuing operations	\$ (0.06)	\$ 0.26	\$ 1.35	\$ 0.91
Earnings from discontinued operations, net of tax	0.02	0.07	0.03	1.77
Basic (loss) earnings per share	\$ (0.04)	\$ 0.33	\$ 1.38	\$ 2.68
Diluted (loss) earnings per share:				
(Loss) earnings from continuing operations	\$ (0.06)	\$ 0.25	\$ 1.30	\$ 0.88

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Earnings from discontinued operations, net of tax	0.02	0.07	0.03	1.72
Diluted (loss) earnings per share	\$ (0.04)	\$ 0.32	\$ 1.33	\$ 2.60
Weighted average number of basic shares outstanding	74,039	73,820	73,957	73,801
Weighted average number of diluted shares outstanding	74,039	76,383	76,795	76,155
<b>(a) Interest expense includes:</b>				
Interest expense on debt	\$ (43.9)	\$ (41.4)	\$ (125.8)	\$ (136.3)
Mark-to-market losses on interest rate swaps	(10.0)	(13.4)	(6.8)	(15.4)
Deferred financing costs	(2.4)	(2.2)	(7.1)	(6.9)
Total	\$ (56.3)	\$ (57.0)	\$ (139.7)	\$ (158.6)

See accompanying notes to condensed consolidated financial statements.

**ROCKWOOD HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Dollars in millions, except per share amounts;****shares in thousands)****(Unaudited)**

	September 30, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 410.3	\$ 350.1
Accounts receivable, net	585.6	460.3
Inventories	629.4	526.9
Deferred income taxes	24.6	22.6
Prepaid expenses and other current assets	68.7	69.7
Assets of discontinued operations	64.3	75.2
Total current assets	1,782.9	1,504.8
Property, plant and equipment, net	1,770.3	1,508.5
Goodwill	1,736.9	1,730.0
Other intangible assets, net	725.1	675.9
Deferred debt issuance costs, net of accumulated amortization of \$36.9 and \$31.2, respectively	40.9	41.1
Deferred income taxes	15.8	15.4
Other assets	60.2	39.2
Total assets	\$ 6,132.1	\$ 5,514.9
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 276.5	\$ 285.5
Income taxes payable	11.6	9.5
Accrued compensation	89.6	81.5
Restructuring liability	10.5	14.0
Accrued expenses and other current liabilities	222.3	164.3
Deferred income taxes	7.9	7.2
Long-term debt, current portion	81.4	107.4
Liabilities of discontinued operations	14.8	17.1
Total current liabilities	714.6	686.5
Long-term debt	2,752.5	2,474.0
Pension and related liabilities	324.5	327.5
Deferred income taxes	165.8	112.5
Other liabilities	178.4	165.7
Total liabilities	4,135.8	3,766.2
Minority interest	377.2	175.3
Performance restricted stock units	5.2	1.8
Stockholders' equity:		
Common stock (\$0.01 par value, 400,000 shares authorized, 74,153 shares issued and 74,058 shares outstanding at September 30, 2008; 400,000 shares authorized, 73,989 shares issued and 73,895 shares outstanding at December 31, 2007)	0.7	0.7
Paid-in capital	1,161.5	1,156.2
Accumulated other comprehensive income	305.6	371.0
Retained earnings	147.5	45.1

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Treasury stock, at cost		(1.4)		(1.4)
Total stockholders' equity		1,613.9		1,571.6
Total liabilities and stockholders' equity	\$	6,132.1	\$	5,514.9

See accompanying notes to condensed consolidated financial statements.

## ROCKWOOD HOLDINGS, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

(Unaudited)

	Nine months ended September 30,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 102.4	\$ 198.0
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of tax	(2.9)	(15.6)
Gain on sale of discontinued operations, net of tax		(115.7)
Minority interest in discontinued operations		0.1
Depreciation and amortization	190.6	152.6
Deferred financing costs amortization	7.1	6.9
Loss on early extinguishment of debt (including \$4.1 of non-cash write-offs on deferred financing costs)		18.6
Foreign exchange loss (gain)	12.2	(11.3)
Fair value adjustment of derivatives	6.8	15.4
Bad debt provision	0.9	1.2
Acquired in-process research and development	2.8	
Stock-based compensation	6.3	2.4
Deferred income taxes	14.2	24.3
Gain on sale of assets and other	(1.8)	(5.3)
Minority interest in continuing operations	(0.4)	6.2
Changes in assets and liabilities, net of the effect of foreign currency translation and acquisitions:		
Accounts receivable	(60.5)	(35.7)
Inventories, including inventory write-up charges	(45.0)	(1.1)
Prepaid expenses and other assets	6.4	(5.7)
Accounts payable	(29.1)	(25.0)
Income taxes payable	3.4	5.8
Accrued expenses and other liabilities	26.1	39.8
Net cash provided by operating activities of continuing operations	239.5	255.9
Net cash provided by operating activities of discontinued operations	11.9	35.9
<b>Net cash provided by operating activities</b>	<b>251.4</b>	<b>291.8</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisitions, including transaction fees paid, net of cash acquired	(181.7)	(168.3)
Post closing purchase price consideration	29.1	
Capital expenditures, excluding capital leases	(157.1)	(135.5)
Proceeds from formation of Viance joint venture, net		73.0
Proceeds on sale of assets	4.3	13.7
Net cash used in investing activities of continuing operations	(305.4)	(217.1)
Net cash (used in) provided by investing activities of discontinued operations, including sale proceeds of \$421.1 for the nine months ended September 30, 2007	(5.1)	416.3
<b>Net cash (used in) provided by investing activities</b>	<b>(310.5)</b>	<b>199.2</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock, net of fees	2.4	0.7
Titanium Dioxide Pigments venture financing	362.5	
Payment of assumed debt to Titanium Dioxide Pigments venture minority shareholder	(141.4)	
Repayment of 2011 Notes		(273.4)
Repayment of senior secured credit facilities	(68.7)	(57.1)



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Repayment of senior secured credit facilities revolver				(37.0)
Payments on other long-term debt		(30.7)		(22.2)
Deferred financing costs		(5.0)		
Payments related to early extinguishment of debt				(14.5)
Distribution to minority shareholder		(3.9)		
Net cash provided by (used in) financing activities of continuing operations		115.2		(403.5)
Net cash used in financing activities of discontinued operations				
<b>Net cash provided by (used in) financing activities</b>		115.2		(403.5)
Effect of exchange rate changes on cash and cash equivalents		4.1		(9.6)
Net increase in cash and cash equivalents		60.2		77.9
Less increase in cash and cash equivalents from discontinued operations, net (a)				(1.6)
Increase in cash and cash equivalents from continuing operations		60.2		76.3
Cash and cash equivalents of continuing operations, beginning of period		350.1		27.7
Cash and cash equivalents of continuing operations, end of period	\$	410.3	\$	104.0

(a) - Excludes \$11.2 of intercompany transfers, net of \$4.4 of sale-related cash outflows for the nine months ended September 30, 2008. Excludes sale proceeds of \$421.1 and intercompany transfers of \$29.5 for the nine months ended September 30, 2007.

Supplemental disclosures of cash flow information:				
Interest paid	\$	104.0	\$	119.2
Income taxes paid, net of refunds	\$	32.9	\$	27.1
Non-cash investing activities:				
Titanium Dioxide Pigments venture formation, net	\$	214.7	\$	
Acquisition of capital equipment	\$	8.0	\$	8.5

See accompanying notes to condensed consolidated financial statements.

**ROCKWOOD HOLDINGS, INC. AND SUBSIDIARIES**

**Notes To Condensed Consolidated Financial Statements (Unaudited)**

**1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

***Business Description, Background*** Rockwood Holdings, Inc. and Subsidiaries is a global developer, manufacturer and marketer of high value-added specialty chemicals and advanced materials used for industrial and commercial purposes. Unless otherwise indicated, any references to we, our, us, the Company or Rockwood refer to Rockwood Holdings, Inc. and its consolidated subsidiaries.

Rockwood was formed in connection with an acquisition of certain assets, stock and businesses from Laporte plc ( Laporte ) on November 20, 2000 (the KKR Acquisition ) by affiliates of Kohlberg Kravis Roberts & Co. L.P. ( KKR ). The businesses acquired focused on specialty compounds, iron-oxide pigments, timber-treatment chemicals, clay-based additives and pool and spa chemicals.

On July 31, 2004, the Company completed the acquisition of certain businesses of Dynamit Nobel from mg technologies ag, now known as GEA Group Aktiengesellschaft ( GEA Group ). The businesses acquired are focused on highly specialized markets and consist of surface treatment and lithium chemicals; advanced ceramics and titanium dioxide pigments.

On January 9, 2007, the Company completed the sale of its Groupe Novasep segment and on December 31, 2007, the Company completed the sale of its Electronics business, excluding its European wafer reclaim business.

On June 17, 2008, funds affiliated with KKR, DLJ Merchant Banking Partners III, L.P. ( DLJMB ) and certain management stockholders sold an aggregate of 10 million shares of the Company's common stock.

On September 1, 2008, the Company completed the formation of a venture with Kemira Oyj ( Kemira ) that focuses on specialty titanium dioxide pigments (See Note 4, Acquisitions, for further details).

On October 10, 2008, the Company completed the sale of its pool and spa chemicals business (See Note 16, Subsequent Event, for further details).

***Basis of Presentation*** The accompanying condensed financial statements of Rockwood are presented on a consolidated basis. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period amounts related to reporting the sale of the Groupe Novasep segment, the Electronics business, excluding the wafer reclaim business, and the pool and spa chemicals business as discontinued operations, have been reclassified to

conform to current-year classification. See Note 2, *Discontinued Operations*, for further details.

The interim financial statements included herein are unaudited. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full year. The condensed consolidated financial statements are presented based upon accounting principles generally accepted in the United States of America ( U.S. GAAP ), except that certain information and footnote disclosures, normally included in financial statements prepared in accordance with U.S. GAAP, have been condensed or omitted. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto contained in the Company's 2007 Form 10-K. In the opinion of management, this information contains all adjustments necessary, consisting of normal and recurring accruals, for a fair presentation of the results for the periods presented.

The Company's minority interest in continuing operations represents the total of the minority party's interest in certain investments (principally the Viance, LLC joint venture and the Titanium Dioxide Pigments venture) that are consolidated but less than 100% owned. On January 2, 2007, Chemical Specialties, Inc. ( CSI ), a wholly-owned subsidiary of the Company within the Timber Treatment Chemicals business of the Performance Additives segment, and Rohm and Haas Company completed the formation of Viance, LLC, a joint venture company that provides an extensive range of advanced wood treatment technologies and services to the global wood treatment industry. In accordance with the consolidation principles of FIN 46 (R), *Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51*, the Company has concluded that Rockwood is the primary beneficiary of the joint venture and as such has consolidated the joint venture.

As noted above, the Company completed a Titanium Dioxide Pigments venture with Kemira in September 2008. The Company has consolidated this venture and has reported Kemira's interest as minority interest in the condensed consolidated financial statements. The water treatment business formerly within the Titanium Dioxide Pigments segment was not part of the transaction and is now being reported within the Clay-based Additives business in the Performance Additives segment. As a result, the Company's financial statements have been reclassified to reflect the water treatment business as part of the Performance Additives segment for the periods presented. See Note 4, *Acquisitions*, for further details.

Unless otherwise noted, all amounts which are denominated in currencies other than the U.S. dollar are converted at the September 30, 2008 exchange rate of 1.00 = \$1.4093.

***Nature of Operations/Segment Reporting*** The Company is a global developer, manufacturer and marketer of high value-added

specialty chemicals and advanced materials. The Company currently operates in various business lines within its five reportable segments consisting of: (1) Specialty Chemicals, which includes lithium compounds and chemicals, metal surface treatment chemicals, and synthetic metal sulfides, (2) Performance Additives, which includes color pigments and services, timber treatment chemicals and clay-based additives, (3) Titanium Dioxide Pigments, which consists of titanium dioxide pigments, and zinc- and barium-based compounds, (4) Advanced Ceramics, which includes ceramic-on-ceramic ball head and liner components used in hip-joint prostheses systems, ceramic cutting tools and a range of other ceramic components and (5) Specialty Compounds, which consists of plastic compounds. As discussed above, the Company sold its Electronics business, excluding its European wafer reclaim business, in December 2007. As a result, the European wafer reclaim business is included within Corporate and other for all periods presented (See Note 3, Segment Information, for further details). The Company completed the sale of its pool and spa chemicals business in October 2008. As a result, the Company's financial statements have been reclassified to reflect the pool and spa chemicals business as a discontinued operation for the periods presented.

The basis for determining an enterprise's operating segments is the manner in which financial information is used internally by the enterprise's chief operating decision maker, the Company's Chief Executive Officer. See Note 3, Segment Information, for further segment reporting information.

**Use of Estimates** The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the periods reported. These estimates include, among other things, assessing the collectibility of accounts receivable, the use and recoverability of inventory, the valuation of deferred tax assets, the measurement of the accrual for uncertain tax benefits, impairment of goodwill as well as property, plant and equipment and other intangible assets, the accrual of environmental and legal reserves and the useful lives of tangible and intangible assets, among others. Actual results could differ from those estimates. Such estimates also include the fair value of assets acquired and liabilities assumed allocated to the purchase price of business combinations consummated.

**Risks Associated with International Operations and Currency Risk** The Company's international operations are subject to risks normally associated with foreign operations, including, but not limited to, the disruption of markets, changes in export or import laws, restrictions on currency exchanges and the modification or introduction of other governmental policies with potentially adverse effects. A majority of the Company's sales and expenses are denominated in currencies other than U.S. dollars. Changes in exchange rates may have a material effect on the Company's reported results of operations and financial position. In addition, a significant portion of the Company's indebtedness is denominated in euros.

**Related Party Transactions** Rockwood has engaged in transactions with certain related parties including KKR and DLJMB and affiliates of each. Information concerning certain transactions is included in the Company's 2007 Form 10-K. Credit Suisse Securities (USA) LLC, an affiliate of DLJMB, served as an underwriter in the secondary offering of the Company's stock by certain stockholders in June 2008. The Company did not receive any proceeds in that offering or pay any commissions. Except for the aforementioned secondary offering, there have not been additional related party transactions for the period ended September 30, 2008.

**Revenue Recognition** The Company recognizes revenue when the earnings process is complete. Product sales are recognized when products are shipped to the customer in accordance with the terms of the contract of sale, title and risk of loss have been transferred, collectibility is reasonably assured, and pricing is fixed or determinable. Accruals are made for sales returns and other allowances based on the Company's experience. Revenue under service agreements, which was less than 1% of consolidated net sales in 2007, is realized when the service is performed. Liabilities for product warranties are less than 1% of consolidated net sales as of September 30, 2008 and December 31, 2007.

**Foreign Currency Translation** The functional currency of each of the Company's foreign subsidiaries is primarily the respective local currency. Balance sheet accounts of the foreign operations are translated into U.S. dollars at period-end exchange rates and income and expense accounts are translated at average exchange rates during the period. Translation gains and losses related to net assets located outside the U.S. are shown as a component of accumulated other comprehensive income. Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the entity's functional currency), including intercompany financing arrangements for which settlement is planned or anticipated, are included in determining net income for the period in which exchange rates change. Gains or losses on certain intercompany loans that are of a long-term investment nature for which settlement is not planned or anticipated in the foreseeable future and gains or losses on euro-denominated debt that is designated as a net investment hedge of the Company's euro-denominated investments are reported and accumulated in the same manner as translation adjustments. These loans are all related to intercompany debt arrangements. As of September 30, 2008, intercompany debt arrangements deemed to be of a long-term investment nature for which settlement is not planned or anticipated in the foreseeable future is predominantly related to \$519.4 million (or \$732.0 million at September 30, 2008) of intercompany loans.

**Derivatives** The Company accounts for derivatives based on Statement of Financial Accounting Standards (SFAS) 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted. SFAS 133 requires that all derivatives be recognized as either assets or liabilities at fair value. Changes in the fair value of derivatives not designated as hedging instruments are recognized currently in earnings while changes in the fair value of derivatives that are designated as hedging instruments are recognized as a component of comprehensive income. The Company uses derivative instruments to manage its exposure to market

risks associated with fluctuations in interest rates and foreign currency exchange rates. See *Comprehensive Income* section of Note 1 for the impact of the Company's net investment hedges. The Company does not enter into derivative contracts for trading purposes nor does it use leveraged or complex instruments.

***Pension, Postemployment and Postretirement Costs*** Defined benefit costs and liabilities have been determined in accordance with SFAS 87, *Employers' Accounting for Pensions* and SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*. Other postretirement benefit costs and liabilities have been determined in accordance with SFAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* and SFAS 158. Postemployment benefit costs and liabilities have been determined in accordance with SFAS 112, *Employers' Accounting for Postemployment Benefits*.

***Income Taxes*** Income taxes are determined in accordance with SFAS 109, *Accounting for Income Taxes* and Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes* *An Interpretation of FASB Statement No. 109*. The Company's U.S. operations are included in a consolidated federal income tax return. The amount of current and deferred tax expense is computed on a separate entity basis for each member of the group based on applying the principles of SFAS 109. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts and the corresponding tax carrying amounts of assets and liabilities. Deferred tax assets are also recognized for tax loss and tax credit carryforwards. A valuation allowance is recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized based on available evidence weighted toward evidence that is objectively verifiable. Deferred taxes are not provided on the undistributed earnings of subsidiaries as such amounts are considered to be permanently invested or could be distributed to the parent company in a tax free manner. It is the Company's policy that the valuation allowance is reversed in the period management determines it is more likely than not that the deferred tax assets will be realized.

FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to not be sustained upon audit by the relevant authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition.

***Comprehensive Income*** Comprehensive income includes net income and the other comprehensive income components which include unrealized gains and losses from foreign currency translation and from certain intercompany transactions that are of a long-term investment nature, pension-related adjustments that are recorded directly into a separate section of stockholders' equity in the balance sheets and net investment hedges. Foreign currency translation amounts are not adjusted for income taxes since they relate to indefinite length investments in non-U.S. subsidiaries and certain intercompany debt.

Comprehensive income (loss) is summarized as follows:

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(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
Pension related adjustments, net of tax	(1.3)	(0.8)	(0.9)	(0.7)
Foreign currency translation	(190.9)	77.9	(71.4)	139.3
Intercompany foreign currency loans	(86.6)	38.3	(25.1)	49.9
Net investment hedge, net of tax	125.8	(54.8)	32.0	(79.2)
Total comprehensive (loss) income	\$ (156.3)	\$ 85.3	\$ 37.0	\$ 307.3

In November 2004, the Company completed the sale of 375.0 million aggregate principal amount of 7.625% senior subordinated notes and \$200.0 million aggregate principal amount of 7.500% senior subordinated notes, both due in 2014 ( 2014 Notes ). In connection with the 2014 Notes, the Company entered into a cross-currency swap with a five-year term and a notional amount of 155.6 million that effectively converted the U.S. dollar fixed-rate debt in respect of the dollar notes sold into euro fixed-rate debt. The Company has designated this contract as a hedge of the foreign currency exposure of its net investment in its euro-denominated operations. There was no ineffective portion of the net investment hedge as of September 30, 2008. The Company does not expect any of the loss on the net investment hedge residing in comprehensive income at September 30, 2008 to be reclassified into earnings during the subsequent twelve months.

In addition, the Company designated the remaining portion of the euro-denominated debt that is recorded on the U.S. books as a net investment hedge of our euro-denominated investments (euro-denominated debt of 663.0 million or \$934.4 million). As a result, any foreign currency gains and losses resulting from the euro-denominated debt discussed above are accounted for as a component of accumulated other comprehensive income. There was no ineffective portion of the net investment hedge as of September 30, 2008. The Company does not expect any of the loss on the net investment hedge residing in comprehensive income at September 30, 2008 to

be reclassified into earnings during the subsequent twelve months.

**Accounting for Environmental Liabilities** In the ordinary course of business, Rockwood is subject to extensive and changing federal, state, local and foreign environmental laws and regulations, and has made provisions for the estimated financial impact of environmental cleanup related costs. Rockwood's policy has been to accrue costs of a non-capital nature related to environmental clean-up when those costs are believed to be probable and can be reasonably estimated. If the aggregate amount of the obligation and the amount and timing of the cash payments for a site are fixed or reliably determinable, the liability is discounted. Expenditures that extend the life of the related property or mitigate or prevent future environmental contamination are capitalized and expenditures related to existing conditions resulting from past or present operations and from which no current or future benefit is discernible are immediately expensed. The quantification of environmental exposures requires an assessment of many factors, including changing laws and regulations, advancements in environmental technologies, the quality of information available related to specific sites, the assessment stage of each site investigation and the length of time involved in remediation or settlement. In some matters, Rockwood may share costs with other parties. Rockwood does not include anticipated recoveries from insurance carriers or other third parties in its accruals for environmental liabilities.

**Cash and Cash Equivalents** All highly liquid instruments and money market funds with an original maturity of three months or less are considered to be cash equivalents. The carrying amount approximates fair value because of the short maturities of these instruments.

**Stock-Based Compensation** The Company has in place the 2005 Amended and Restated Stock Purchase and Option Plan of Rockwood Holdings, Inc. and Subsidiaries (the Plan). Under the Plan, the Company may grant stock options, restricted stock and other stock-based awards to the Company's employees and directors and allow employees and directors to purchase shares of its common stock. There are 10,000,000 authorized shares available for grant under the Plan. Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payment*, and related interpretations and began expensing the grant-date fair value of stock options.

The compensation cost for stock options, restricted stock units and Board of Director stock grants recorded under the Plan resulted in a decrease to income from continuing operations before taxes and minority interest of \$2.2 million and \$1.5 million for the three months ended September 30, 2008 and 2007, respectively, and \$6.3 million and \$2.2 million for the nine months ended September 30, 2008 and 2007, respectively. See Note 10, *Stock-Based Compensation*, for further details.

The Company granted additional stock options and performance restricted stock units in 2007 to certain employees of Rockwood Corporate Headquarters and its business units. The performance restricted stock units contain a provision in which the units shall immediately vest and become converted into the right to receive a cash payment upon a change in control as defined in the equity agreement. As the provisions for redemption are outside the control of the Company, the fair value of these units as of September 30, 2008 have been recorded as mezzanine equity (outside of permanent equity) in the Condensed Consolidated Balance Sheets.

**Recent Accounting Pronouncements** The following represents the impact of recently issued accounting pronouncements:



In September 2006, SFAS No. 157, *Fair Value Measurements*, was issued. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. Certain disclosure provisions of this standard were effective for the Company as of January 1, 2008 and are disclosed in Note 14, Fair Value Measurements. The adoption of SFAS No. 157 did not have a material impact on the Company's financial statements.

In September 2006, SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*, was issued. The Company adopted the recognition provisions of SFAS No. 158 and initially applied them to the funded status of its defined benefit postretirement plans as of December 31, 2006. This statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for the Company for the 2008 fiscal year end. The Company does not expect a material impact on its financial statements as a result of this change in 2008.

In February 2007, SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*, was issued. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value and permits all entities to choose to measure eligible items at fair value at specified election dates. This statement is effective for the Company as of January 1, 2008. The Company adopted this standard on January 1, 2008. However, the Company has elected not to measure any instruments at fair value under SFAS No. 159.

In December 2007, SFAS No. 141 (revised 2007), *Business Combinations* ( FAS 141R ) was issued, which replaces FASB Statement No. 141, *Business Combinations*. FAS 141R establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. This statement also establishes disclosure requirements to enable users of financial statements to evaluate the nature and financial effects of the business combination. This statement is effective for acquisitions completed on or after January 1, 2009.

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In December 2007, SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*, was issued. Per this statement, the accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity (but separate from parent's equity). This statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for the Company as of January 1, 2009. The Company is currently evaluating the impact this statement will have on its financial statements, primarily relating to its Viance, LLC joint venture and its Titanium Dioxide Pigments venture, as discussed above.

In December 2007, the SEC issued Staff Accounting Bulletin (SAB) No. 110, which provided interpretive guidance regarding the use of a simplified method, as discussed in SAB No. 107, in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123R, *Share-Based Payment*. SAB 110 is effective for share options granted as of January 1, 2008. SAB 110 extended the use of the simplified method beyond December 31, 2007, under certain circumstances, which included not having sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time a company's equity shares have been publicly traded. As Rockwood became a public company in August 2005, there is not sufficient historical exercise data available to estimate expected term. As a result, the Company will continue to use the simplified method to estimate expected term for share option grants until more relevant detailed information becomes widely available.

In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretive Accounting Pronouncements That Address Leasing Transactions*, and FSP FAS 157-2, *Effective Date of FASB Statement No. 157*. FSP FAS 157-1 removes leasing from the scope of SFAS No. 157. FSP FAS 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company will apply the provisions of FSP 157-2 on January 1, 2009 and does not expect this FSP to have a material impact on its financial statements.

In March 2008, SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement 133* was issued. This statement changes the disclosure requirements for derivative instruments and hedging activities, including enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for the Company as of January 1, 2009. The Company does not expect this statement to have a material impact on its financial statements.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), *Business Combinations*, and other U.S. GAAP. This FSP is effective for recognized intangible assets acquired after January 1, 2009. The Company is currently evaluating the impact this FSP will have on its financial statements.

In May 2008, SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, was issued. This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). This Statement shall be effective as of November 15, 2008. As issued by the FASB, the effective date of this statement was tied to the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company does not expect this statement to have a material impact on its financial statements.

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In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This FSP clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. This FSP is effective upon issuance, including prior periods for which financial statements have not been issued. This FSP did not have an impact on the Company's condensed consolidated financial statements.

### **2. DISCONTINUED OPERATIONS:**

On October 10, 2008, the Company completed the sale of its pool and spa chemicals business and received approximately \$124.0 million in cash. As of September 30, 2008, the Company met the criteria for reporting the pending sale of this business as an asset held for sale and discontinued operations pursuant to SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. As a result, the Company's financial statements have been reclassified to reflect this business as a discontinued operation for all periods presented.

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On January 9, 2007, the Company completed the sale of its Groupe Novasep segment. The transaction was valued at approximately 425.0 million, which included the repayment of third party and intercompany indebtedness. In connection with SFAS No. 144, the Company's financial statements have been reclassified to reflect the Groupe Novasep segment as a discontinued operation for all periods presented.

On December 31, 2007, the Company completed the sale of its Electronics business, excluding its European wafer reclaim business, for \$315.6 million. In connection with SFAS No. 144, the Company's financial statements have been reclassified to reflect the Electronics business sold as a discontinued operation for all periods presented.

Operating results of the discontinued operations of the pool and spa chemicals business for the three and nine months ended September 30, 2008 were as follows:

(\$ in millions)	Three months ended September 30, 2008		Nine months ended September 30, 2008	
Net sales	\$	19.5	\$	52.0
Cost of products sold		13.5		37.4
Gross profit		6.0		14.6
Selling, general and administrative expenses		3.5		10.3
Operating income		2.5		4.3
Other expenses:				
Interest expense		(0.2)		(0.2)
Other		(0.5)		(0.5)
Other expenses		(0.7)		(0.7)
Income before taxes		1.8		3.6
Income tax provision		0.3		0.7
Net income	\$	1.5	\$	2.9

Operating results of the discontinued operations of the pool and spa chemicals business and the Electronics business for the three months ended September 30, 2007 were as follows:

(\$ in millions)	Pool and Spa Chemicals Business		Electronics Business		Total	
Net sales	\$	15.7	\$	50.8	\$	66.5
Cost of products sold		10.5		38.0		48.5
Gross profit		5.2		12.8		18.0
Selling, general and administrative expenses		3.3		7.5		10.8
Operating income		1.9		5.3		7.2
Other income (expenses):						
Interest income				0.2		0.2
Foreign exchange loss, net				(0.2)		(0.2)
Other, net				0.1		0.1
Other income, net				0.1		0.1
Income before taxes		1.9		5.4		7.3
Income tax provision		0.8		1.0		1.8
Net income	\$	1.1	\$	4.4	\$	5.5



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Operating results of the discontinued operations of the pool and spa chemicals business, the Electronics business and Groupe Novasep for the nine months ended September 30, 2007 were as follows:

(\$ in millions)	Pool and Spa Chemicals Business	Electronics Business	Groupe Novasep	Total
Net sales	\$ 48.1	\$ 147.2	\$ 8.9	\$ 204.2
Cost of products sold	32.8	109.4	7.0	149.2
Gross profit	15.3	37.8	1.9	55.0
Selling, general and administrative expenses	10.2	22.7	1.0	33.9
Gain on sale of business/assets			(117.7)	(117.7)
Operating income	5.1	15.1	118.6	138.8
Other income (expenses):				
Interest expense	(0.1)		(0.3)	(0.4)
Interest income		0.9		0.9
Loss on early extinguishment of debt	(0.5)	(0.3)		(0.8)
Other income (expenses), net	(0.6)	0.6	(0.3)	(0.3)
Income before taxes and minority interest	4.5	15.7	118.3	138.5
Income tax provision	1.8	3.3	2.1	7.2
Net income before minority interest	2.7	12.4	116.2	131.3
Minority interest, net of tax			(0.1)	(0.1)
Net income	\$ 2.7	\$ 12.4	\$ 116.1	\$ 131.2

The carrying values of the assets and liabilities of the pool and spa chemicals business included in the Condensed Consolidated Balance Sheets are as follows:

	September 30, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Accounts receivable, net	\$ 10.4	\$ 23.4
Inventories	11.4	8.5
Prepaid expenses and other current assets	0.7	1.0
Property, plant and equipment, net	3.8	4.3
Goodwill	37.0	37.0
Other intangible assets, net	0.9	0.9
Deferred income taxes	0.1	0.1
Total assets to be disposed	\$ 64.3	\$ 75.2
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 7.0	\$ 7.7
Income taxes payable	2.3	3.2
Accrued compensation	1.4	1.6
Accrued expenses and other current liabilities	2.1	1.5
Other liabilities	2.0	3.1
Total liabilities to be disposed	\$ 14.8	\$ 17.1

As of September 30, 2007, the Company had received net cash proceeds of \$421.1 million from the sale of Groupe Novasep. These proceeds were reported as net cash provided by investing activities of discontinued operations for the nine months ended September 30, 2007 in the Company's Condensed Consolidated Statements of Cash Flows. Net cash proceeds for the year ended December 31, 2007 from the sale of Groupe Novasep were \$420.7 million. The net gain on the Groupe Novasep sale recorded in the first quarter of 2007 was \$115.7 million (net of \$2.0 million of German taxes).

**3. SEGMENT INFORMATION:**

Rockwood operates in five reportable segments according to the nature and economic characteristics of its products and services as well as the manner in which the information is used internally by the Company's key decision maker, who is the Company's Chief Executive Officer. The five segments are: (1) Specialty Chemicals, which consists of the surface treatment and fine chemicals business lines; (2) Performance Additives, which consists of color pigments and services, timber treatment chemicals and clay-based

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additives; (3) Titanium Dioxide Pigments; (4) Advanced Ceramics; and (5) Specialty Compounds.

Items that cannot be readily attributed to individual segments have been classified as Corporate and other. Corporate and other operating loss primarily represents payroll, professional fees and other operating expenses of centralized functions such as treasury, tax, legal, internal audit and consolidation accounting as well as the cost of operating our central offices (including some costs maintained based on legal or tax considerations). The primary components of Corporate and other loss, in addition to operating loss, are interest expense on external debt (including the amortization of deferred financing costs), foreign exchange losses or gains, and mark-to-market gains or losses on derivatives. Major components within the reconciliation of income before taxes (described more fully below) include systems/organization establishment expenses, interest expense on external debt, foreign exchange losses or gains, and refinancing expenses related to external debt. Corporate and other identifiable assets primarily represent deferred financing costs that have been capitalized in connection with corporate external debt financing, deferred income tax assets and cash balances maintained in accordance with centralized cash management techniques. The Corporate and other classification also includes the results of operations, assets (primarily real estate) and liabilities (including pension and environmental) of legacy businesses formerly belonging to Dynamit Nobel and the wafer reclaim business. The European wafer reclaim business line is a provider of semiconductor wafer refurbishment services with market positions in Europe. This business works with semiconductor manufacturers to refurbish used test wafers and return them to the manufacturer for reuse in test and process monitor applications. In February 2007, the Company completed the sale of its U.S. wafer reclaim business.

In September 2008, the Company completed the formation of its Titanium Dioxide Pigments venture. The water treatment business of the Titanium Dioxide Pigments segment has been retained and is being reported within the Clay-based Additives business in the Performance Additives segment. As a result, the Company's financial statements have been reclassified to reflect the water treatment business as part of the Performance Additives segment for the periods presented.

Summarized financial information for each of the reportable segments is provided in the following table:

(\$ in millions)	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Specialty Compounds	Corporate and other	Consolidated
<b>Three months ended September 30, 2008</b>							
Net sales	\$ 319.5	\$ 223.2	\$ 140.6	\$ 126.4	\$ 68.6	\$ 2.5	\$ 880.8
Total Adjusted EBITDA (a)	78.8	28.6	23.9	38.1	7.9	(14.1)	163.2
<b>Three months ended September 30, 2007</b>							
Net sales	\$ 261.4	\$ 203.7	\$ 113.8	\$ 111.7	\$ 69.8	\$ 2.7	\$ 763.1
Total Adjusted EBITDA (a)	58.2	40.8	21.8	30.7	7.8	(13.8)	145.5
<b>Nine months ended September 30, 2008</b>							
Net sales	\$ 966.7	\$ 676.8	\$ 380.8	\$ 404.9	\$ 210.8	\$ 7.8	\$ 2,647.8
Total Adjusted EBITDA (a)	241.4	99.5	60.2	121.5	26.7	(41.8)	507.5
<b>Nine months ended September 30, 2007</b>							
Net sales	\$ 800.2	\$ 590.8	\$ 334.7	\$ 335.8	\$ 210.2	\$ 9.4	\$ 2,281.1
Total Adjusted EBITDA (a)	192.8	119.5	60.9	92.2	25.4	(41.5)	449.3

Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Specialty Compounds	Corporate and other (b)	Eliminations (c)	Consolidated (d)
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Identifiable assets as of:																
September 30, 2008	\$	2,042.3	\$	1,384.6	\$	1,247.2	\$	821.2	\$	271.9	\$	497.8	\$	(197.2)	\$	6,067.8
December 31, 2007		1,900.1		1,344.2		764.8		843.6		281.8		464.3		(159.1)		5,439.7

(a) This amount does not include \$2.7 million and \$5.1 million of Adjusted EBITDA for the three and nine months ended September 30, 2008, respectively, and \$2.2 million and \$5.9 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the pool and spa chemicals business sold in October 2008. This amount also excludes \$9.6 million and \$27.3 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the Electronics business sold on December 31, 2007 and \$1.8 million of Adjusted EBITDA for the nine months ended September 30, 2007 from the former Groupe Novasep segment sold on January 9, 2007.

(b) This amount includes \$52.9 million and \$56.5 million of assets from legacy businesses at September 30, 2008 and December 31, 2007, respectively. These businesses were formerly owned primarily by Dynamit Nobel.

(c) Amounts contained in the Eliminations column represent the individual subsidiaries retained interest in their cumulative net cash balance (deposits less withdrawals) included in the corporate centralized cash system and within the identifiable assets of the respective segment. These amounts are eliminated as the corporate centralized cash system is included in the Corporate segment's identifiable assets.

(d) This amount does not include \$64.3 million and \$75.2 million of identifiable assets at September 30, 2008 and December 31, 2007, respectively, from the pool and spa chemicals business sold in October 2008. Total identifiable assets including these amounts were \$6,132.1 million and \$5,514.9 million at September 30, 2008 and December 31, 2007, respectively.

Geographic information regarding net sales based on seller's location and long-lived assets are described in Note 4, Segment Information, in the Company's 2007 Form 10-K.

On a segment basis, the Company defines Adjusted EBITDA as operating income excluding depreciation and amortization, certain non-cash gains and charges, certain other special gains and charges deemed by senior management to be non-recurring gains and charges and certain items deemed by senior management to have little or no bearing on the day-to-day operating performance of its business segments and reporting units. The adjustments made to operating income directly correlate with the adjustments to net income in calculating Adjusted EBITDA on a consolidated basis pursuant to the senior secured credit agreement, which reflects management's interpretations thereof. The indenture governing the 2014 Notes excludes certain adjustments permitted under the senior credit agreement. Senior management uses Adjusted EBITDA on a segment basis as the primary measure to evaluate the ongoing performance of the Company's business segments and reporting units.

The Company uses Adjusted EBITDA on a segment basis to assess its operating performance. Because the Company views Adjusted EBITDA on a segment basis as an operating performance measure, the Company uses income (loss) from continuing operations before taxes and minority interest as the most comparable GAAP measure.

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The following table presents a reconciliation of income (loss) from continuing operations before taxes and minority interest to Adjusted EBITDA on a segment GAAP basis:

(\$ in millions)	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Specialty Compounds	Corporate and other	Consolidated
<b>Three months ended September 30, 2008</b>							
Income (loss) from continuing operations before taxes and minority interest	\$ 44.5	\$ (5.2)	\$ (1.5)	\$ 17.0	\$ 2.5	\$ (52.8)	\$ 4.5
Interest expense (a)	14.6	7.8	8.6	8.5	2.3	14.5	56.3
Interest income	1.0	1.0	(0.1)	0.1	(0.1)	(2.5)	(0.6)
Depreciation and amortization	17.8	17.2	14.3	11.8	2.6	1.9	65.6
Restructuring charges, net	0.6	1.6		0.4	0.4	0.4	3.4
Systems/organization establishment expenses	0.6	1.4	0.7	0.1	0.1	0.8	3.7
Cancelled acquisition and disposal costs		0.1			0.1		0.2
Inventory write-up charges	0.1	1.5	2.1				3.7
(Gain) loss on sale of assets and other	(0.5)			0.1		(2.3)	(2.7)
Acquired in-process research and development		2.8					2.8
Foreign exchange loss (gain), net	0.3	0.3	(0.1)	0.2		25.8	26.5
Other	(0.2)	0.1	(0.1)	(0.1)		0.1	(0.2)
Total Adjusted EBITDA (b)	\$ 78.8	\$ 28.6	\$ 23.9	\$ 38.1	\$ 7.9	\$ (14.1)	\$ 163.2
<b>Three months ended September 30, 2007</b>							
Income (loss) from continuing operations before taxes and minority interest	\$ 34.9	\$ 15.7	\$ 3.4	\$ 11.4	\$ 3.0	\$ (30.3)	\$ 38.1
Interest expense (a)	11.5	6.9	8.0	8.6	2.3	19.7	57.0
Interest income	(1.2)	(0.1)	0.1	(0.1)	(0.3)	(0.1)	(1.7)
Depreciation and amortization	13.5	14.4	10.2	10.1	2.9	1.5	52.6
Restructuring charges, net	1.4	0.7		0.7		0.1	2.9
Systems/organization establishment expenses		0.4		0.3	(0.1)		0.6
Cancelled acquisition and disposal costs	(0.1)		0.4			1.7	2.0
Inventory write-up charges	0.1	2.6					2.7
(Gain) loss on sale of assets and other	(0.4)	0.2	0.1				(0.1)
Foreign exchange gain, net	(0.6)	(0.2)	(0.4)	(0.3)		(6.3)	(7.8)
Other	(0.9)	0.2				(0.1)	(0.8)
Total Adjusted EBITDA (b)	\$ 58.2	\$ 40.8	\$ 21.8	\$ 30.7	\$ 7.8	\$ (13.8)	\$ 145.5
<b>Nine months ended September 30, 2008</b>							
Income (loss) from continuing operations before taxes and minority interest	\$ 148.7	\$ 13.1	\$ (9.0)	\$ 59.2	\$ 10.8	\$ (73.1)	\$ 149.7
Interest expense (a)	41.0	22.6	26.6	26.4	6.9	16.2	139.7
Interest income	(0.9)	1.1	(0.1)	(0.1)	(0.4)	(3.8)	(4.2)
Depreciation and amortization	51.0	50.9	39.3	35.6	8.3	5.5	190.6
Restructuring charges, net	0.8	3.2		0.9	0.4	0.4	5.7
Systems/organization establishment expenses	1.4	3.6	0.7	0.3	0.3	0.8	7.1
Cancelled acquisition and disposal costs		0.1			0.4	0.4	0.9
Inventory write-up charges	0.6	1.5	2.1				4.2
(Gain) loss on sale of assets and other	(0.5)		0.8	0.2		(2.3)	(1.8)
Acquired in-process research and development		2.8					2.8
Foreign exchange loss (gain), net		0.1	(0.1)	(0.9)		13.1	12.2
Other	(0.7)	0.5	(0.1)	(0.1)		1.0	0.6
Total Adjusted EBITDA (b)	\$ 241.4	\$ 99.5	\$ 60.2	\$ 121.5	\$ 26.7	\$ (41.8)	\$ 507.5
<b>Nine months ended September 30, 2007</b>							
Income (loss) from continuing operations before taxes and minority interest	\$ 125.6	\$ 61.5	\$ 6.3	\$ 35.3	\$ 9.0	\$ (107.9)	\$ 129.8
Interest expense (a)	30.5	11.7	23.9	25.2	7.0	60.3	158.6

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Interest income	(2.9)	(0.6)		(0.1)	(0.5)	(6.0)	(10.1)
Depreciation and amortization	39.9	40.4	29.9	29.8	8.4	4.2	152.6
Restructuring charges, net	1.9	1.0		1.4		4.6	8.9
Systems/organization establishment expenses	(0.4)	0.9		0.9	0.4		1.8
Cancelled acquisition and disposal costs			1.1			1.7	2.8
Inventory write-up charges	0.1	2.6		0.1			2.8
Loss on early extinguishment of debt		1.4			1.1	16.1	18.6
Refinancing expenses						0.9	0.9
(Gain) loss on sale of assets and other	(0.4)	0.3	0.1			(5.3)	(5.3)
Foreign exchange gain, net	(0.3)	(0.2)	(0.4)	(0.4)		(10.0)	(11.3)
Other	(1.2)	0.5				(0.1)	(0.8)
Total Adjusted EBITDA (b)	\$ 192.8	\$ 119.5	\$ 60.9	\$ 92.2	\$ 25.4	\$ (41.5)	\$ 449.3

(a) Includes losses of \$10.0 million and \$13.4 million for the three months ended September 30, 2008 and 2007, respectively, and losses of \$6.8 million and \$15.4 million for the nine months ended September 30, 2008 and 2007, respectively, representing the movement in the mark-to-market valuation of the Company's interest rate and cross-currency hedging instruments.

(b) This amount does not include \$2.7 million and \$5.1 million of Adjusted EBITDA for the three and nine months ended September 30, 2008, respectively, and \$2.2 million and \$5.9 million of Adjusted EBITDA for the three and nine months ended

September 30, 2007, respectively, from the pool and spa chemicals business sold in October 2008. In addition, this amount does not include \$9.6 million and \$27.3 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the Electronics business sold on December 31, 2007 and \$1.8 million of Adjusted EBITDA for the nine months ended September 30, 2007 from the former Groupe Novasep segment sold on January 9, 2007.

The summary of segment information above includes Adjusted EBITDA, a financial measure used by the Company's chief decision maker and senior management to evaluate the operating performance of each segment.

*Items excluded from Adjusted EBITDA*

Certain items are added to or subtracted from income (loss) from continuing operations before taxes and minority interest to derive Adjusted EBITDA, as defined below. These items include the following:

- *Restructuring and related charges:* Restructuring charges of \$3.4 million and \$2.9 million were recorded in the three months ended September 30, 2008 and 2007, respectively, and \$5.7 million and \$8.9 million were recorded in the nine months ended September 30, 2008 and 2007, respectively, for miscellaneous restructuring activities, including headcount reductions and facility closures (see Note 13, Restructuring Liability, for further details).
- *Systems/organization establishment expenses:* For the three and nine months ended September 30, 2008, expenses of \$3.7 million and \$7.1 million, respectively, were recorded related to the integration of businesses acquired, primarily related to the acquisition of the Elementis plc business in the Performance Additives segment in August 2007 and the completion of the Titanium Dioxide Pigments venture on September 1, 2008. For the three and nine months ended September 30, 2007, expenses of \$0.6 million and \$1.8 million, respectively, were recorded related to the integration of businesses acquired.
- *Cancelled acquisition and disposal costs:* Costs of \$0.2 million and \$2.0 million were recorded for the three months ended September 30, 2008 and 2007, respectively, and costs of \$0.9 million and \$2.8 million were recorded for the nine months ended September 30, 2008 and 2007, respectively, in connection with non-consummated acquisitions and dispositions. Approximately \$1.6 million of costs were incurred in 2007 related to the expected sale of the electronics business.
- *Inventory write-up charges:* Under SFAS 141, *Business Combinations*, all inventories acquired in an acquisition must be revalued to fair value. In connection with acquisitions, the Company allocates a portion of the total purchase price to inventory to reflect manufacturing profit in inventory at the date of the acquisitions. This resulted in a reduction of gross profit of \$3.7 million and \$4.2 million for the three and nine months ended September 30, 2008, respectively, primarily related to the acquisition of Holliday Pigments in August 2008 in the Performance Additives segment and the completion of the Titanium Dioxide Pigments venture and \$2.7 million and

\$2.8 million for the three and nine months ended September 30, 2007, respectively, primarily related to the acquisition of the Elementis plc businesses in the third quarter of 2007.

- *Acquired in-process research and development:* Under SFAS 141, *Business Combinations*, acquired in-process research and development costs are charged to expense as of the acquisition date. For the three and nine months ended September 30, 2008, the Company expensed \$2.8 million related to the acquisition of Holliday Pigments in August 2008 in the Performance Additives segment.
- *Loss on early extinguishment of debt:* In the second quarter of 2007, the Company paid a redemption premium of \$14.5 million and wrote off \$4.1 million of deferred financing costs associated with the redemption of the 2011 Notes on May 15, 2007.
- *Refinancing expenses:* In March 2007, the Company expensed \$0.9 million related to the fourth amendment of the senior secured credit agreement to refinance all outstanding borrowings under the tranche F term loans with new tranche G term loans.
- *(Gain) loss on sale of assets and other:* The Company recorded a gain on the sale of assets and other of \$2.7 million for the three months ended September 30, 2008 primarily related to the sale of land that was acquired as part of the acquisition of Dynamit Nobel in 2004. For the nine months ended September 30, 2008, a gain of \$1.8 million was recorded related to the sale of land discussed above, partially offset by the liquidation of a joint venture in the Titanium Dioxide Pigments segment. The Company recorded a gain of \$5.3 million for the nine months ended September 30, 2007 primarily related to the sale of the U.S. wafer reclaim business.
- *Foreign exchange (gain) loss, net:* For the three and nine months ended September 30, 2008, the Company recorded losses of \$26.5 million and \$12.2 million, respectively, due to the impact of a weaker euro related to non-operating euro-denominated transactions and intercompany financing arrangements. For the three and nine months ended September 30, 2007, gains of \$7.8 million and \$11.3 million, respectively, were recorded due to the impact of the stronger euro related to non-operating euro-denominated transactions and intercompany financing arrangements.

#### 4. ACQUISITIONS:

Pursuant to the Company's business strategy of achieving profitable growth through selective acquisitions, the Company has acquired several businesses in recent years. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, any goodwill resulting from acquisitions is tested for impairment at least annually.

On August 31, 2007, the Company completed the acquisition of the global color pigments business of Elementis plc for a purchase price of approximately \$140.0 million. This acquisition includes facilities in North America, Europe and China and is included in the Color Pigments and Services business, which is part of the Performance Additives segment. The allocation of the purchase price to the identifiable assets acquired and the liabilities assumed is complete.

On August 11, 2008, the Company completed the acquisition of Holliday Pigments, the leading global manufacturer of technical grade ultramarine blue and manganese violet pigments, from Yule Catto & Co. plc for a purchase price of approximately 46.0 million (\$68.6 million using an August 11, 2008 exchange rate of \$1.4909). Holliday Pigments manufactures inorganic ultramarine pigments for a wide range of applications, including plastics, cosmetics, coatings and inks. Holliday Pigments was incorporated into the Color Pigments and Services business, which is part of the Performance Additives segment. The allocation of the purchase price to the identifiable assets acquired is preliminary and is subject to change, with estimated completion during the first half of 2009.

On September 1, 2008, the Company completed the formation of a venture with Kemira that focuses on specialty titanium dioxide pigments. The venture combines the Company's titanium dioxide pigments and functional additives businesses, which are part of the Titanium Dioxide Pigments segment, including its production facility in Duisburg, Germany, and Kemira's titanium dioxide business, including Kemira's titanium dioxide plant in Pori, Finland. The Company has consolidated this venture and has reported Kemira's interest as minority interest in the condensed consolidated financial statements. The Company owns 61% of the venture with Kemira owning the remaining portion. The venture's acquisition of the shares of the Rockwood and Kemira entities was facilitated by the borrowings under a term loan of 250.0 million on September 3, 2008 (\$362.5 million using a September 3, 2008 exchange rate of 1.4498). The venture made a payment of 97.5 million (\$141.4 million using a September 3, 2008 exchange rate) to the venture's minority shareholder. In addition, the venture obtained a 30.0 million (\$42.3 million) revolving credit facility to finance its operations and the venture has assumed debt of 25.2 million (\$35.5 million) from Kemira, primarily due to a defined benefit pension plan. The Company estimates that the potential exposure range for assumed environmental liabilities is from \$14.1 million to \$25.3 million. At September 30, 2008, \$14.1 million of related reserves are recorded. The purchase accounting allocation is preliminary and is subject to change, with estimated completion during 2009.

On September 4, 2008, the Company completed the acquisition of Nalco Holdings, Inc.'s (Nalco) Finishing Technologies business for a purchase price of approximately \$75.0 million. Nalco's Finishing Technologies business provides chemicals and services for pre-treating of metal and is part of the Surface Treatment business within the Specialty Chemicals segment. The allocation of the purchase price to the identifiable assets acquired is preliminary and is subject to change, with estimated completion during the first half of 2009.

In addition to the acquisitions described above, the Company has completed other smaller acquisitions in 2007 and in the first nine months of 2008. Depending on the timing and complexity involved, the purchase price allocation to the net assets acquired for certain acquisitions completed within the last year was preliminary as of September 30, 2008.

The above acquisitions were not material on an individual basis, or in the aggregate.

**5. INVENTORIES:**

Inventories are comprised of the following:

(\$ in millions)	September 30, 2008 (a)	December 31, 2007
Raw materials	\$ 211.7	\$ 184.6
Work-in-process	73.0	60.7
Finished goods	336.9	275.5
Packaging materials	7.8	6.1
Total	\$ 629.4	\$ 526.9

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(a) The increase from December 31, 2007 is primarily related to the Titanium Dioxide Pigment venture and other acquisitions, net of the impact of currency changes.



**6. GOODWILL:**

Below are goodwill balances and activity by segment:

(\$ in millions)	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Specialty Compounds	Total
Balance, December 31, 2007	\$ 684.1	\$ 493.9	\$ 172.3	\$ 258.5	\$ 121.2	\$ 1,730.0
Post closing purchase price consideration (a)	(18.2)		(6.0)	(4.9)		(29.1)
Acquisitions (b)	11.0	31.1	53.8			95.9
Foreign exchange and other (c)	(21.2)	(17.4)	(6.3)	(8.5)	(6.5)	(59.9)
Balance, September 30, 2008	\$ 655.7	\$ 507.6	\$ 213.8	\$ 245.1	\$ 114.7	\$ 1,736.9

(a) In March 2008, the Company entered into an agreement with GEA Group and GEA North America to settle all existing and future environmental claims in consideration of payment to the Company of 18.8 million (\$29.1 million) which was received on March 28, 2008. This payment was considered an adjustment to the purchase price per the claims settlement agreement between the Company and GEA Group and its subsidiary. As a result, the Company has reported this as an adjustment to the purchase price with a credit to goodwill in the first quarter of 2008. See Note 15, Commitments and Contingencies, for further details.

(b) Primarily related to goodwill from the Titanium Dioxide Pigments venture, the Holliday Pigments acquisition in the Performance Additives segment and the acquisition of Nalco's Finishing Technologies business in the Specialty Chemicals segment.

(c) Consists primarily of foreign currency changes.

**7. OTHER INTANGIBLE ASSETS:**

Other intangible assets, net consist of:

(\$ in millions)	As of September 30, 2008			As of December 31, 2007		
	Gross Carrying Amount (a)	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Patents and other intellectual property	\$ 408.6	\$ (136.0)	\$ 272.6	\$ 395.6	\$ (116.7)	\$ 278.9

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Trade names and trademarks	139.7	(25.9)	113.8	146.6	(23.0)	123.6
Customer relationships	331.8	(72.6)	259.2	273.0	(57.3)	215.7
Supply agreements	59.7	(5.2)	54.5	29.6	(2.9)	26.7
Other	58.3	(33.3)	25.0	57.7	(26.7)	31.0
Total	\$ 998.1	\$ (273.0)	\$ 725.1	\$ 902.5	\$ (226.6)	\$ 675.9

(a) The increase from December 31, 2007 is primarily related to the impact of acquisitions, net of the impact of currency changes.

Amortization of other intangible assets was \$20.2 million and \$16.5 million for the three months ended September 30, 2008 and 2007, respectively and \$58.8 million and \$47.8 million for the nine months ended September 30, 2008 and 2007, respectively.

Estimated amortization expense for each of the five succeeding fiscal years is as follows:

(\$ in millions) Year ended	Amortization Expense
2008	\$ 79.1
2009	73.7
2010	71.2
2011	67.8
2012	66.4

## 8. LONG-TERM DEBT

Long-term debt and loans payable are summarized as follows:

(\$, and £ in millions)	September 30, 2008	December 31, 2007
Senior secured credit facilities:		
Tranche A-1 term loans ( 22.8 and 29.3, respectively)	\$ 32.2	\$ 42.8
Tranche A-2 term loans ( 99.4 and 127.8, respectively)	140.1	186.5
Tranche E term loans	1,104.9	1,116.4
Tranche G term loans ( 265.2 and 267.9, respectively)	373.7	390.9
2014 Notes ( 375.0 and \$200.0 as of September 30, 2008 and December 31, 2007)	728.5	747.1
Titanium Dioxide Pigments venture term loans ( 250.0 as of September 30, 2008)	352.3	
Capitalized lease obligations ( 32.4 and 34.1, respectively)	45.7	49.7
Other loans	56.5	24.2
Preferred stock of subsidiary (£12.0 as of December 31, 2007)		23.8
	2,833.9	2,581.4
Less current maturities	(81.4)	(107.4)
	\$ 2,752.5	\$ 2,474.0

The Titanium Dioxide Pigments venture entered into a facility agreement that provides for a term loan facility in an aggregate amount of 250.0 million and a revolving credit facility in an aggregate amount of 30.0 million (\$42.3 million), both maturing on June 17, 2013. On September 3, 2008, the Titanium Dioxide Pigments venture borrowed 250.0 million (\$352.3 million) under the term loan facility. As of September 30, 2008, there were no outstanding borrowings under this revolving credit facility. The interest rate on the loans is EURIBOR (or LIBOR if the currency is not EURO) plus 3%, subject to a step down determined by reference to a leverage ratio test. The term loan shall be repaid in installments over a five-year period from the date of the facility agreement, with payments commencing twelve months from such date; both loans may be repaid in advance without penalty. In addition, the Titanium Dioxide Pigments venture has assumed debt of 25.2 million (\$35.5 million) from Kemira at interest rates ranging from 3.75% to 5.00%.

## 9. INCOME TAXES:

Income tax expense has been computed based on the projected effective tax rate for the year. The effective tax rate for the nine months ended September 30, 2008 and 2007 was 33.8% and 43.8%, respectively. The effective tax rate is lower in 2008 compared to 2007 primarily as a result of lower statutory rates in various European countries, geographic mix, the 2008 allocation of tax benefits to continuing operations primarily related to other comprehensive income, partially offset by increased domestic losses which are not tax effected as a result of a full valuation allowance for federal and certain state taxes. The difference between the effective tax rate and the U.S. federal statutory rate of 35.0% is primarily a function of favorable foreign rate differentials, the impact of the valuation allowance on domestic losses and the allocation of benefits to continuing operations.

In the nine months ended September 30, 2008, the Company decreased its worldwide valuation allowances by \$4.0 million. The decrease in the valuation allowance was primarily due to a reduction of domestic losses in other comprehensive income, the offset of net operating losses against uncertain tax benefit liabilities, reduced by an increase in deferred tax assets generally associated with the Company's domestic earnings. The change in the valuation allowance for the nine months ended September 30, 2008 increased the tax provision by \$16.3 million. The following table reflects the activity in the valuation allowance for worldwide net operating losses and other deferred income tax assets:

(\$ in millions)		Valuation Allowance
Balance as of December 31, 2007	\$	100.1
Increase as reflected in income tax expense		16.3
Decrease as reflected in other comprehensive income (a)		(16.1)
Decrease due to the offset of net operating losses against uncertain tax position liabilities		(4.2)
Balance as of September 30, 2008	\$	96.1

(a) Primarily related to net investment hedges, as well as the mark-to-market of the Company's Euro-denominated debt.

In the nine months ended September 30, 2008, based on the Company's policy and review of available information, including the Company's steady-state analysis, it was determined that there was not sufficient positive evidence of future taxable income to release the U.S. Federal valuation allowance that has been recorded. During the nine months ended September 30, 2008, the Company's net U.S. Federal deferred tax assets and liabilities were maintained at a zero level, other than a noncurrent deferred tax liability relating to goodwill with an indefinite reversal period and a noncurrent deferred tax asset relating to a Federal AMT Credit. It is the Company's policy that the valuation allowance is reversed in the year management determines it is more likely than not that the deferred tax assets will be realized.

In the second quarter of 2008, the Company determined that it was necessary to establish a valuation allowance for certain state deferred tax assets. This resulted in a \$0.4 million increase in the tax provision related to the beginning of period deferred tax balance.

Unrecognized tax benefits at September 30, 2008 were \$27.9 million. This includes \$25.2 million of tax benefits that, if recognized, would affect the effective tax rate, \$2.3 million of tax benefits that if recognized, would result in a decrease to goodwill recorded in purchase business combinations and \$0.4 million of tax benefits that, if recognized, would result in an adjustment to other tax

accounts.

The Company recognizes interest and penalties related to unrecognized tax benefits in its income tax provision. The Company had accrued \$4.3 million for interest and penalties at December 31, 2007. During the nine months ended September 30, 2008, the accrual for interest and penalties was increased by \$2.3 million to \$6.6 million.

During the next twelve months, it is reasonably possible that resolution of uncertain tax liabilities could result in a benefit of up to \$3.0 million or a cost of up to \$22.0 million. Audit outcomes and the timing of audit settlements are subject to significant uncertainty.

The Company is subject to taxation in the U.S., various states, and foreign jurisdictions. The Company's tax filings in major jurisdictions are open to investigation by tax authorities; in the U.S. from 2000, in the U.K. from 2003, and in Germany from 2000.

#### **10. STOCK-BASED COMPENSATION:**

The Company has in place the 2005 Amended and Restated Stock Purchase and Option Plan of Rockwood Holdings, Inc. and Subsidiaries (the Plan). Under the Plan, the Company may grant stock options, restricted stock and other stock-based awards to the Company's employees and directors and allow employees and directors to purchase shares of its common stock. There are 10,000,000 authorized shares available for grant under the Plan.

In December 2007, the Company awarded 167,951 performance restricted stock units to management and key employees which will vest on December 31, 2010 as long as the employee continues to be employed by the Company on this date and upon the achievement of certain performance targets. The number of shares of the Company's common stock ultimately awarded upon vesting is determined based on the achievement of specified performance criteria over the period January 1, 2008 through December 31, 2010. However, in accordance with SFAS No. 123R, the Company did not recognize any compensation cost in 2007 for this issuance because the performance measures that form the basis for vesting of these restricted stock units were not known as of December 31, 2007. These performance measures were established on February 29, 2008, when the Company's financial statements for 2007 were filed with the Securities and Exchange Commission. The weighted average grant date fair value of these restricted stock units was \$30.69 per stock unit.

The compensation cost for stock options, restricted stock units and Board of Director stock grants recorded under the Plan resulted in a decrease to income from continuing operations before taxes and minority interest of \$2.2 million and \$1.5 million for the three months ended September 30, 2008 and 2007, respectively, and \$6.3 million and \$2.2 million for the nine months ended September 30, 2008 and 2007, respectively. The total tax benefit recognized related to stock options was \$0.3 million and \$0.2 million for the three months ended September 30, 2008 and 2007, respectively, and \$0.7 million and \$0.3 million for the nine months ended September 30, 2008 and 2007, respectively.

#### **11. EMPLOYEE BENEFIT PLANS:**

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The following table represents the net periodic benefit costs and related components in accordance with SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Service cost	\$ 2.0	\$ 1.9	\$ 5.7	\$ 5.7
Interest cost	7.7	5.8	22.0	17.3
Expected return on assets	(3.4)	(2.1)	(8.9)	(6.3)
Net amortization of actuarial losses (gains)		0.1	(0.1)	0.3
Total pension cost	\$ 6.3	\$ 5.7	\$ 18.7	\$ 17.0

As part of the Titanium Dioxide Pigments venture, the Company assumed responsibility for two defined benefit plans. Summary information as of the formation of the venture (September 1, 2008) is as follows:

(\$ in millions)	
Fair value of plan assets	\$ 169.5
Benefit obligation	158.5
Funded status	\$ 11.0
Discount rate assumption	5.75%
Expected return on plan assets	5.00%

**12. EARNINGS PER COMMON SHARE:**

Basic and diluted (loss) earnings per common share ( EPS ) were computed using the following common share data:

(\$ in millions, except per share amounts; shares in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>EPS Numerator - Basic:</b>				
Net (loss) income from continuing operations	\$ (4.8)	\$ 19.2	\$ 99.5	\$ 66.8
Income from discontinued operations, net of tax	1.5	5.5	2.9	15.6
Gain on sale of discontinued operations, net of tax				115.7
Minority interest in discontinued operations, net of tax				(0.1)
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
<b>EPS Denominator - Basic:</b>				
Weighted average number of common shares outstanding	74,039	73,820	73,957	73,801
<b>Basic (loss) earnings per common share:</b>				
(Loss) earnings from continuing operations	\$ (0.06)	\$ 0.26	\$ 1.35	\$ 0.91
Earnings from discontinued operations, net of tax	0.02	0.07	0.03	1.77
Basic (loss) earnings per common share	\$ (0.04)	\$ 0.33	\$ 1.38	\$ 2.68
<b>EPS Numerator - Diluted:</b>				
Net (loss) income from continuing operations	\$ (4.8)	\$ 19.2	\$ 99.5	\$ 66.8
Income from discontinued operations, net of tax	1.5	5.5	2.9	15.6
Gain on sale of discontinued operations, net of tax				115.7
Minority interest in discontinued operations, net of tax				(0.1)
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
<b>EPS Denominator - Diluted:</b>				
Weighted average number of common shares outstanding	74,039	73,820	73,957	73,801
Effect of dilutive stock options and other incentives		2,563	2,838	2,354
Weighted average number of common shares outstanding and common stock equivalents	74,039	76,383	76,795	76,155
<b>Diluted (loss) earnings per common share:</b>				
(Loss) earnings from continuing operations	\$ (0.06)	\$ 0.25	\$ 1.30	\$ 0.88
Earnings from discontinued operations, net of tax	0.02	0.07	0.03	1.72
Diluted (loss) earnings per common share	\$ (0.04)	\$ 0.32	\$ 1.33	\$ 2.60

For the three months ended September 30, 2008, the effect of stock-based awards, computed on the treasury stock method, have been excluded from the diluted earnings per share calculation since the effect of such securities is anti-dilutive. Stock-based awards under employee compensation plans representing common stock of 1,026,414 shares were outstanding during the nine months ended September 30, 2008 and 523,697 shares were outstanding during the three and nine months ended September 30, 2007, but were not included in the computation of diluted earnings per common share because their inclusion would have had an anti-dilutive effect.

**13. RESTRUCTURING LIABILITY:**

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The Company recorded restructuring charges of \$3.4 million and \$2.9 million for the three months ended September 30, 2008 and 2007, respectively and \$5.7 million and \$8.9 million for the nine months ended September 30, 2008 and 2007, respectively. The Company records restructuring liabilities that represent charges incurred in connection with consolidations and cessations of certain of its operations, including operations from acquisitions, as well as headcount reduction programs. These charges consist primarily of write-offs of assets and severance costs. Severance charges are based on various factors including the employee's length of service, contract provisions, salary levels and local governmental legislation. At the time a related charge is recorded, the Company calculates its best estimate based upon detailed analysis. Although significant changes are not expected, actual costs may differ from these estimates.

During the nine months ended September 30, 2008, the Company expensed \$5.7 million of restructuring charges. In the Color Pigments and Services business, a restructuring plan was implemented in connection with the integration of the business acquired from Elementis plc which includes the reorganization and relocation of its North American Finance and IT services and the closure of three manufacturing facilities by the end of 2008. The Company recorded \$2.3 million of severance costs and \$0.5 million of asset write-offs related to this restructuring plan. In the Timber Treatment Chemicals business, \$0.4 million was recorded for miscellaneous headcount reductions. In the Advanced Ceramics, Specialty Chemicals and Specialty Compounds segments, \$0.9 million, \$0.8 million and \$0.4 million, respectively, were recorded for miscellaneous headcount reductions. In the Corporate and other segment, facility closure costs of \$0.4 million were recorded related to the restructuring of the wafer reclaim business.



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During the nine months ended September 30, 2007, the Company expensed \$8.9 million of restructuring charges. In the Corporate and other segment, facility closure and severance costs of \$4.6 million were recorded primarily related to the restructuring of the wafer reclaim business. In addition, \$1.9 million was recorded in the Specialty Chemicals segment and \$1.4 million was recorded in the Advanced Ceramics segment for miscellaneous headcount reductions. In the Performance Additives segment, \$1.0 million was recorded for miscellaneous headcount reductions and facility closures.

In 2006, the Company recorded restructuring charges for miscellaneous restructuring items, including miscellaneous headcount reductions and the closure of an administrative office in the Specialty Chemicals segment. In the Corporate and other segment, charges were recorded primarily related to the restructuring of the wafer reclaim business. This included severance and related costs for employees in connection with the closure of two wafer reclaim facilities. The Company closed a wafer reclaim facility in the U.K. in January 2006 and one of the facilities in the U.S. in March 2006. In addition, charges were recorded in the Performance Additives and Advanced Ceramics segments primarily for miscellaneous headcount reductions.

In 2005, the Company recorded restructuring charges for miscellaneous restructuring actions, including the announced closure of the Baulking, United Kingdom facility in the Clay-based Additives business and the announced restructuring of the wafer reclaim business. The Company recorded severance and related costs for employees in connection with the closure of the wafer reclaim facilities (one each in the U.K. and U.S.). In addition, miscellaneous headcount reductions were recorded in the Specialty Chemicals, Performance Additives and Advanced Ceramics segments.

In 2004, the Company recorded restructuring charges to involuntarily terminate or relocate certain employees and/or exit certain activities as a result of the Dynamit Nobel Acquisition. As a result, the Company closed the former corporate office of Dynamit Nobel and recorded charges related to this closure including severance costs for personnel, the closure costs on the building and the relocation costs of the remaining employees who were relocated to the Company's new location. Also, as part of the acquisition of the Pigments and Dispersions business of Johnson Matthey, the Company enacted a restructuring program and eliminated certain positions.

Selected information for the 2008 restructuring actions follows:

(\$ in millions)	Severance	Facility Closure	Relocation Costs	Write-Downs	Total
<b>2008</b>					
Liability balance, December 31, 2007	\$	\$	\$	\$	\$
Acquisitions	1.4				1.4
Restructuring charge in 2008	4.6	0.3	0.1	0.5	5.5
Utilized in 2008	(3.7)	(0.2)	(0.1)	(0.5)	(4.5)
Foreign exchange and other	(0.1)				(0.1)
Liability balance, September 30, 2008	\$ 2.2	\$ 0.1	\$	\$	\$ 2.3

These actions are expected to be completed during 2008 and 2009.

Selected information for the 2007 restructuring actions follows:

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(\$ in millions)	Severance	Facility Closure	Relocation	Total
<b>2007</b>				
Liability balance, December 31, 2007	\$ 6.1	\$ 0.3	\$ 0.3	\$ 6.7
Utilized in 2008	(1.8)	(0.8)		(2.6)
Foreign exchange and other	(1.9)	2.9	(0.3)	0.7
Liability balance, September 30, 2008	\$ 2.4	\$ 2.4	\$	\$ 4.8

These actions are expected to be completed during 2008 and 2009.

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Selected information for the 2006 restructuring actions follows:

(\$ in millions)	Severance	Facility Closure	Relocation	Total
<b>2006</b>				
Liability balance, December 31, 2007	\$ 1.3	\$ 4.1	\$ 0.1	\$ 5.5
Restructuring charge in 2008		0.3		0.3
Utilized in 2008	(1.6)	(1.3)		(2.9)
Foreign exchange and other	0.3	(0.6)		(0.3)
Liability balance, September 30, 2008	\$	\$ 2.5	\$ 0.1	\$ 2.6

The severance and relocation costs related to the acquisition in the Specialty Compounds segment are expected to be completed during 2008. The facility closure costs from the 2006 restructuring actions primarily relate to the restructuring of the wafer reclaim business and the closure of two wafer reclaim facilities. The facility closure costs are expected to be completed when the lease expires in 2018.

Selected information for the 2005 restructuring actions follows:

(\$ in millions)	Severance	Facility Closure	Total
<b>2005</b>			
Liability balance, December 31, 2007	\$ 0.2	\$ 0.2	\$ 0.4
Foreign exchange and other	(0.2)		(0.2)
Liability balance, September 30, 2008	\$	\$ 0.2	\$ 0.2

These actions are expected to be completed in 2008.

Selected information for the 2004 restructuring actions follows:

(\$ in millions)	Severance	Facility Closure	Relocation	Total
<b>2004</b>				
Liability balance, December 31, 2007	\$ 0.8	\$ 0.2	\$ 0.4	\$ 1.4
Restructuring charge in 2008	(0.1)			(0.1)
Utilized in 2008	(0.1)	(0.1)		(0.2)
Foreign exchange and other	(0.1)		(0.4)	(0.5)
Liability balance, September 30, 2008	\$ 0.5	\$ 0.1	\$	\$ 0.6

These actions are expected to be substantially completed by the end of 2008.

Restructuring reserves by segment are as follows:

(\$ in millions)	September 30, 2008	December 31, 2007
Specialty Chemicals	\$ 1.7	\$ 3.4
Performance Additives	3.8	4.6
Titanium Dioxide Pigments	1.4	
Advanced Ceramics	0.4	0.8
Specialty Compounds	0.5	2.4
Corporate and other	2.7	2.8
	\$ 10.5	\$ 14.0

#### 14. FAIR VALUE MEASUREMENTS:

As discussed in Note 1, Description of Business and Summary of Significant Accounting Policies, SFAS No. 157, *Fair Value Measurements*, was issued in September 2006. This statement defines fair value, establishes a framework for measuring fair value in GAAP, and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. This statement does not require any new fair value measurements, but requires disclosure of how the fair values of any assets and liabilities that are measured at fair value on a recurring basis are determined. Certain provisions of this standard were effective for the Company as of January 1, 2008 and are disclosed below. However, the FASB has deferred the implementation of SFAS No. 157 by one year for non-financial assets and liabilities. Under SFAS No. 159, *The Fair Value Option for Financial Assets*

and Financial Liabilities Including an Amendment of FASB Statement No. 115, entities are permitted to choose to measure many financial instruments and certain other items at fair value. The Company has elected not to measure any instruments at fair value under SFAS No. 159.

As of September 30, 2008, the only assets and liabilities that the Company currently measures at fair value on a recurring basis are derivatives and marketable securities. The Company's financial assets and liabilities are measured using inputs from the three levels of the fair value hierarchy. The three levels are as follows:

- Level 1 Inputs are unadjusted quoted market prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 Inputs are directly or indirectly observable, which include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 Inputs are unobservable inputs that are used to measure fair value to the extent observable inputs are not available. The Company does not have any financial assets or liabilities that are classified as Level 3 inputs as of September 30, 2008.

In accordance with the fair value hierarchy, the following table provides the fair value of the Company's financial assets and liabilities that are required to be measured at fair value as of September 30, 2008:

	As of		Fair Value Measurements		
	September 30, 2008		Level 1	Level 2	Level 3
<b>Assets</b>					
Marketable securities (a)	\$	322.2	\$ 322.2	\$	\$
Interest rate swaps (b)		1.9		1.9	
Total assets at fair value	\$	324.1	\$ 322.2	\$ 1.9	\$
<b>Liabilities</b>					
Interest rate swaps (b)	\$	23.2	\$	23.2	\$
Cross-currency interest rate swaps (c)		5.3		5.3	
Cross-currency interest rate swaps - net investment hedge (d)		19.4		19.4	
Raw material purchase hedge (e)		0.4		0.4	
Total liabilities at fair value	\$	48.3	\$	48.3	\$

- (a) These primarily represent money market funds with an original maturity of three months or less.
- (b) The Company has historically entered into interest rate swaps to manage its exposure to changes in interest rates related to variable rate debt. As of September 30, 2008, these contracts cover notional amounts of \$610.0 million (at interest rates ranging from 4.864% to 5.038%) and 288.0 million (at an interest rate of 4.416%). These derivative contracts effectively convert the senior secured credit obligations to fixed rate obligations. These hedges will mature between November 2009 and July 2012. The Company has elected not to apply hedge accounting for these interest rate swaps and has recorded the mark-to-market of these derivatives as a component of interest expense in the Condensed Consolidated Statements of Operations.
- (c) The Company entered into cross-currency interest rate swaps with current notional amounts of \$19.3 million and 17.0 million that effectively convert U.S. dollar borrowings into euro-based obligations at an effective interest rate of EURIBOR plus 4%. These

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contracts have final maturity dates of July 2010. The Company has elected not to apply hedge accounting for these interest rate swaps and has recorded the mark-to-market of these derivatives as a component of interest expense in the Condensed Consolidated Statements of Operations.

- (d) In connection with the offering of the 2014 Notes, the Company entered into a cross-currency interest rate swap in November 2004 with a notional amount of 155.6 million that effectively converts the U.S. dollar fixed rate debt in respect of the 2014 dollar-denominated notes sold into euro fixed rate debt. This swap has a final maturity date of November 2009. The Company designated this contract as a hedge of the foreign currency exposure of its net investment in its euro-denominated operations. As a result, any foreign currency gains and losses resulting from the translation of this euro-denominated debt is accounted for as a component of accumulated other comprehensive income for as long as the hedge remains effective.
- (e) In March 2008, the Titanium Dioxide Pigments segment entered into a derivative contract to protect a portion of its exposure to movements in certain raw material prices. The Company has elected not to apply hedge accounting for this derivative contract and has recorded the mark-to-market of this derivative in cost of products sold in the Condensed Consolidated Statements of

Operations.

The fair values of marketable securities are based on unadjusted quoted market prices from various financial information service providers and securities exchanges. The fair values of derivatives are based on quoted market prices from various banks for similar instruments.

#### **Counter-party risk**

The Company manages counter-party risk by entering into derivative contracts with only major financial institutions of investment grade quality and by limiting the amount of exposure to each financial institution. The Company has considered credit adjustments to the fair value of its derivative assets and liabilities as of September 30, 2008 based on market participant assumptions. In addition, based on the credit evaluation of each institution comprising our derivative assets as of September 30, 2008, the Company has determined the carrying values of these assets as of September 30, 2008 to be fully realizable.

#### **15. COMMITMENTS AND CONTINGENCIES:**

**Legal Proceedings** The Company is involved in various legal proceedings, including commercial, intellectual property, product liability and environmental matters of a nature considered normal to its business. It is the Company's policy to accrue for amounts related to these matters in accordance with SFAS No. 5, *Accounting for Contingencies*, if it is probable that a liability has been incurred and an amount can be reasonably estimated. It is the Company's policy to disclose such matters when there is at least a reasonable possibility that a material loss may have been incurred.

In April 2005, Hospira Incorporated filed suit in Mecklenburg County, North Carolina Superior Court against one of the Company's wholly-owned subsidiaries in its Specialty Compounds segment alleging claims for negligence, negligent misrepresentation, estoppel, fraud, third party beneficiary breach of contract and unfair trade practices as a result of the subsidiary providing PVC compound to its customer. Hospira is seeking damages of approximately \$16.0 million for costs allegedly related to its recall and destruction of intravenous administration kits that incorporated components made with this compound, and further seeks treble damages of approximately \$48.0 million, plus attorneys fees and interest, under the North Carolina unfair trade practice statute. The Court dismissed Hospira's negligence and estoppel claims, but initially denied the subsidiary's motion to dismiss the other claims. Following discovery, the Company's subsidiary filed a motion for summary judgment to dismiss the remaining claims and, on November 9, 2007, the trial court granted the Company's motion for summary judgment and dismissed all of the plaintiff's claims. The appellate court heard oral arguments in October 2008. The Company cannot predict how this decision will impact the ultimate resolution of the case; however, the Company will continue to vigorously defend this matter. While the Company believes its subsidiary has meritorious defenses against Hospira's claims and does not believe that resolution of this matter will have a material adverse effect on its business or financial condition, the Company cannot predict the ultimate outcome of this litigation and resolution of this claim may have a material adverse effect on its results of operations or cash flows in any quarterly or annual reporting period.

In addition, a subsidiary in the Specialty Chemicals segment that formerly manufactured sealants for insulating glass and resins for laminated glass prior to and after the sale of this business has been named as a defendant in several lawsuits relating to alleged negligent manufacturing of those products. Pursuant to the sale and purchase agreement with respect to the divested glass business, this subsidiary may be required to pay indemnity claims related to these lawsuits. Although the Company expects its subsidiary to have coverage under its product liability insurance policies should damages ultimately be awarded or agreed to, in such an event, its insurance may not cover such claims and, if not, its subsidiary may not have sufficient cash flow to pay these claims. Although the Company does not believe that resolution of these matters will have a

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material adverse effect on its business or financial condition, the Company cannot predict the ultimate outcome of this litigation, and the resolution of one or more of these claims may have a material adverse effect on its results of operations or cash flows in any quarterly or annual reporting period.

Although the Company expects to continue to pay legal fees in connection with the above matters and other legal actions related to chromated copper arsenate and other product liability matters, based on currently available facts, the Company does not believe that these actions will have a material effect on the financial condition, results of operations or liquidity of the Company.

Reserves in connection with product liability matters do not individually exceed \$3.0 million and in the aggregate \$8.0 million as of September 30, 2008. The Company's reserve estimates are based on available facts, including damage claims and input from its internal and external legal counsel, past experience, and, in some instances where defense costs are being paid by its insurer, known insurance recoveries. The Company is unable to estimate the amount or range of any potential incremental charges should facts and circumstances change and may in the future revise its estimates based on new information becoming available. Further, the Company cannot predict the outcome of any litigation or the potential for future litigation.

**Indemnity Matters** The Company may be indemnified by third parties in connection with certain matters related to acquired businesses. For example, under the terms of the sale and purchase agreement, mg technologies ag (now known as GEA Group Aktiengesellschaft ( GEA Group )) and its subsidiary MG North America Holdings, Inc. (now known as GEA North America Inc. ( GEA North America )), were obligated to indemnify the Company for certain legal, tax and environmental liabilities and obligations that relate to the period prior to the closing, subject to certain limits and exclusions. Pursuant to these agreements, the Company has various claims for indemnification with GEA Group. However, in March 2008, the Company entered into an agreement with GEA Group and GEA North America to settle all existing and future environmental indemnities under the sale and purchase agreement relating to the Dynamit Nobel Acquisition in consideration of payment to the Company of 18.8 million (\$29.1 million),



which was received on March 28, 2008. Although the Company has no reason to believe that the financial condition of those parties who may have indemnification obligations to the Company is other than sound, in the event the Company seeks indemnity under any of these agreements or through other means, there can be no assurance that any party who may have obligations to indemnify the Company will adhere to their obligations and the Company may have to resort to legal action to enforce its rights under the indemnities. In cases where the Company's indemnification claims to such third parties are uncontested, the Company expects to realize recoveries within the short term.

In addition, the Company may be subject to indemnity claims relating to properties or businesses it divested. The Company is required to indemnify the buyer of its former Electronics business, Groupe Novasep segment and pool and spa chemicals business. For example, the Company is required to indemnify the buyer of its Electronics business for certain known and unknown environmental actions which may arise in the future that relate to the period prior to the closing. In the opinion of management, and based upon information currently available, the ultimate resolution of any indemnification obligations owed to the Company or by the Company is not expected to have a material adverse effect on the Company's financial condition, results of operations or cash flows, but may have a material adverse effect on the Company's results of operations or cash flow in any quarterly or annual reporting period.

## **Safety, Health and Environmental Matters**

### ***General***

The Company is subject to extensive environmental, health and safety laws in the United States, the European Union ( EU ) and elsewhere at the international, national, state, and local levels. Many of these laws impose requirements relating to clean-up of contamination, and impose liability in the event of damage to human beings, natural resources or property, and provide for substantial fines, injunctions and potential criminal sanctions for violations. The products, including the raw materials handled, are also subject to rigorous industrial hygiene regulations and investigation. The nature of the Company's operations exposes it to risks of liability for breaches of these laws and regulations as a result of the production, storage, transportation and sale of materials that can cause contamination or personal injury when released into the environment. Environmental laws are subject to change and have tended to become stricter over time. Such changes in environmental laws, or the enactment of new environmental laws, could result in materially increased capital, operating and compliance costs.

### ***Safety, Health and Environmental Management Systems***

The Company is committed to achieving and maintaining compliance with all applicable safety, health and environmental ( SHE ) legal requirements. The Company's subsidiaries have developed policies and management systems that are intended to identify the SHE legal requirements applicable to their operations, enhance compliance with such requirements, ensure the safety of the Company's employees, contractors, community neighbors and customers and minimize the production and emission of wastes and other pollutants. Although SHE legal requirements are constantly changing, these SHE management systems are designed to assist the Company in meeting its compliance goals and minimizing overall risk.

### ***SHE Capital Expenditures***

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The Company may incur future costs for capital improvements and general compliance under SHE laws. For the year ended December 31, 2007, the capital expenditures for SHE matters totaled \$29.6 million, excluding costs to maintain and repair pollution control equipment. For 2008, the Company estimates capital expenditures for compliance with SHE laws to be at similar levels; however, because capital expenditures for these matters are subject to changes in existing and new SHE laws, the Company cannot provide assurance that its recent expenditures will be indicative of future amounts required to comply with these laws.

### *Regulatory Developments*

On June 1, 2007, the Registration, Evaluation and Authorization of Chemicals ( REACH ) legislation became effective in the EU. REACH requires manufacturers and importers of certain chemicals to register those chemicals, perform health and environmental risk analyses of those chemicals, and in certain instances, obtain authorizations for the use of the chemicals. Covered substances must be pre-registered by December 31, 2008. Currently, REACH is expected to be implemented in three phases over the next eleven years based on known product hazards and/or volume of product in commerce. Under REACH, where warranted by a risk assessment, specified uses of some hazardous substances may be restricted. As a specialty chemicals company, it is possible that the Company is the only manufacturer of one or more substances to be regulated under REACH and thus could potentially bear the full cost of compliance with REACH for some or all of the Company's products. The Company estimates it has approximately 350 products that might be subject to REACH. The Company is taking steps to comply with REACH and is evaluating the potential costs of compliance. The Company does not believe these costs will have a material impact on its results of operations, financial position or liquidity. In addition, it is possible that REACH may affect raw material supply, customer demand for certain products and the Company's decision to continue to manufacture and sell certain products.

In addition, the Company is subject to the Homeland Security Agency's regulations, which address chemical plant safety, the Kyoto Protocol, which relates to the emission of greenhouse gasses and the European Union Integrated Pollution Prevention and Control Directive, which relates to environmental permitting programs for individual facilities. The Company does not believe, based upon

currently available information, that these regulations will have a material adverse impact on its results of operations, financial position or liquidity.

**Remediation Liabilities**

Environmental laws have a significant effect on the nature and scope of any clean-up of contamination at current and former operating facilities, the costs of transportation and storage of chemicals and finished products and the costs of the storage and disposal of wastes. In addition, Superfund statutes in the United States as well as statutes in other jurisdictions impose strict, joint and several liability for clean-up costs on the entities that generated waste and/or arranged for its disposal at contaminated third party sites, as well as the past and present owners and operators of contaminated sites. All responsible parties may be required to bear some or all clean-up costs regardless of fault, legality of the original disposal or ownership of the disposal site.

The following table provides a list of the Company's present and former facilities with environmental contamination for which we have reserved for at September 30, 2008:

Country	Location	(a)	(b)	(c)	(d)	(e)
Brazil	Diadema			X		
China	Shenzhen			X		
Finland	Kipsikorski				X	
	Pori				X	
Germany	Duisburg	X			X	
	Hainhausen	X				
	Ibbenburen				X	
	Marktredwitz		X			
	Plochingen		X			
	Stadeln	X				
	Troisdorf	X		X		
Italy	Turin			X		
The Netherlands	Oss	X				
United Kingdom	Barrow-in Furness	X				
	Birtley			X		
	Kidsgrove			X		
United States	Beltsville, MD	X		X		
	East St. Louis, IL			X		
	Easton, PA	X				
	Gonzales, TX				X	
	Harrisburg, NC	X		X		
	La Mirada, CA			X		
	Laurens, SC		X			
	Middletown, NY (formerly owned)			X		X
	New Johnsonville, TN		X			
	Silver Peak, NV	X			X	
	Sunbright, VA (facility closed)	X				X
	Valdosta, GA	X				

(a) The Company is currently operating groundwater monitoring and/or remediation systems at these locations.

- (b) The Company is currently operating groundwater monitoring and/or remediation systems at these locations for which prior owners or insurers have assumed responsibility.
  
- (c) The Company is currently conducting investigations into additional possible soil and/or groundwater contamination at these locations.
  
- (d) The Company has land restoration obligations relating to landfill activities or surface mining at these locations.
  
- (e) The Company is responsible for liabilities related to environmental matters at these closed facilities.

The Company is also responsible for environmental matters at some of its former off-site disposal locations owned by third parties. These sites are considered Superfund sites as defined by the EPA or state regulatory authority. The Company is a potentially responsible party or *de minimis* participant at the following Superfund locations: Casmalia, CA; Laurel, MD; Niagara Falls, NY; South Gate, CA; and Whittier, CA and has reserves for these matters totaling \$0.2 million at September 30, 2008. In addition, the German environmental authorities recently notified the Company, along with a few other potentially responsible parties, of a potential remediation at a former site in Liebenau, Germany. The Company is currently in the process of gathering additional information regarding the site and cannot predict the potential scope of any such remediation. Based upon currently available information, the Company does not believe this matter will have a material effect on its results of operations.

Although the Company cannot provide assurances in this regard, the Company does not believe that these issues will have a material

adverse effect on its business or financial condition, but may have a material adverse effect on the results of operations or cash flows in any given quarterly or annual reporting period. Nonetheless, the discovery of contamination arising from present or historical industrial operations at some of the Company's or its predecessor's former and present properties and/or at sites where the Company and its predecessor disposed wastes could expose the Company to cleanup obligations and other damages in the future.

#### ***Government Enforcement Proceedings and Civil Litigation***

During the course of the Company's business, the Company may receive notices of violation, enforcement and other complaints from regulatory agencies alleging non-compliance with applicable SHE laws. Currently, the Company is a party to a consent order with the Metropolitan Sewer District (MSD) in St. Louis, Missouri to reduce ammonia concentrations in wastewater discharge to a city treatment plant. MSD's new National Pollution Discharge Elimination System (NPDES) permit requires the Company to reduce the facility's ammonia discharge by December 31, 2008. The Company will be required to make capital expenditures of up to \$3.0 million in connection with this matter.

#### ***Environmental Reserves***

The Company has established financial reserves relating to anticipated environmental cleanup obligations, site reclamation and remediation and closure costs, which are reviewed at least quarterly based on currently available information. Liabilities are recorded when potential liabilities are either known or believed to be probable and can be reasonably estimated. In the event that the Company establishes a financial reserve in connection with site remediation costs, the Company records a reserve for the estimated cost of the remediation, even though the costs of the remediation will likely be spread out over many years. The Company does not include unasserted claims in its reserves.

The Company's liability estimates are based upon available facts, existing technology, indemnities from third parties, past experience and, in some instances, insurance recoveries where the remediation costs are being paid directly by its insurers and are generated by several means, including State-mandated schedules, environmental consultants and internal experts, depending on the circumstances. On a consolidated basis, the Company has accrued \$57.4 million and \$40.7 million for known environmental liabilities as of September 30, 2008 and December 31, 2007, respectively, all of which were classified as other non-current liabilities in the Condensed Consolidated Balance Sheets. The increase in the environmental reserve is primarily due to environmental liabilities assumed from the Titanium Dioxide Pigments venture that was completed in September 2008. The environmental liabilities assumed are subject to change upon the finalization of purchase accounting. Included in the \$57.4 million as of September 30, 2008 is \$21.4 million that is discounted using discount rates ranging from 5.0% to 7.5%, with the undiscounted amount of these reserves equaling \$30.7 million. Included in the \$40.7 million as of December 31, 2007 is \$15.8 million that is discounted using discount rates ranging from 5.0% to 7.0%, with the undiscounted amount of these reserves equaling \$22.5 million. In certain cases, the Company's remediation liabilities are payable over periods of up to 30 years. The Company estimates that the potential range for such environmental matters as of September 30, 2008 is from \$57.4 million to \$96.4 million. For the nine months ended September 30, 2008, the Company recorded charges of \$2.5 million to increase its environmental liabilities and made payments of \$1.8 million for clean-up and remediation costs, which reduced its environmental liabilities. For the nine months ended September 30, 2008, the recurring cost of managing hazardous substances for ongoing operations is \$38.4 million. At a number of the sites described above, the extent of contamination has not yet been fully investigated or the final scope of remediation is not yet determinable and could potentially affect the range identified above.

The Company is obligated to undertake soil remediation at two facilities in Europe in the event manufacturing operations are discontinued there at some future date. In addition, in the event that manufacturing operations are discontinued at any of the Company's other facilities with known contamination, regulatory authorities may impose more stringent requirements on the Company including soil remediation. The Company does not contemplate any such action occurring in the foreseeable future, as these facilities' remaining lives are indefinite. Given the indeterminate useful life of these facilities and the corresponding indeterminate settlement date of any soil remediation obligations, the Company does not have sufficient information to estimate a range of potential settlement dates for its obligations. Consequently, the Company cannot employ a present

value technique to estimate fair value and, accordingly, has not accrued for any environmental related costs to remediate soil at these facilities.

The Company believes these accruals are adequate based on currently available information. The Company may incur losses in excess of the amounts accrued; however, based on currently available information it does not believe the additional amount of potential losses would have a material effect on its results of operations or financial condition, but may have a material effect on the results of operations or cash flow in any given quarterly or annual reporting period. The Company does not believe that any known individual environmental matter would have a material effect on its results of operations or financial condition. The Company is unable to estimate the amount or range of any potential incremental charges should facts and circumstances change and may in the future revise its estimates based on new information becoming available.

**16. SUBSEQUENT EVENT:**

On October 10, 2008, the Company completed the sale of its pool and spa chemicals business and received approximately \$124.0 million in cash. This business, which manufactured and marketed branded swimming pool, spa and surface water treatment chemicals primarily through pool and spa professionals and specialty retailers, was part of the Performance Additives segment. As a result, the

Company has accounted for the results of this business as a discontinued operation in the condensed consolidated financial statements. See Note 2, Discontinued Operations, for further details.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*In 2007, we completed the sale of our Groupe Novasep and Electronics businesses, excluding our European wafer reclaim business. In addition, the Company completed the sale of its pool and spa chemicals business in October 2008. As a result, our condensed consolidated financial statements have been reclassified to reflect these businesses as discontinued operations. See Note 2, Discontinued Operations, for further details.*

*The following discussion contains forward-looking statements that involve numerous risks and uncertainties. Our actual results could differ materially from those discussed in the forward-looking statements as a result of these risks and uncertainties, including those set forth in Forward-Looking Statements at the end of this Management Discussion and Analysis section and the risk factors section of the Company's 2007 Form 10-K. You should read the following discussion and analysis together with our condensed consolidated financial statements and the notes to those statements that appear elsewhere in this Quarterly Report. Amounts may not recalculate due to rounding differences.*

*Unless otherwise noted, all amounts which are denominated in currencies other than the U.S. dollar are converted at the September 30, 2008 exchange rate of 1.00 = \$1.4093.*

**General**

We are a global developer, manufacturer and marketer of technologically advanced, high value-added specialty chemicals and advanced materials. We serve more than 60,000 customers across a wide variety of industries and geographic areas. We operate through five business segments: (1) Specialty Chemicals; (2) Performance Additives; (3) Titanium Dioxide Pigments; (4) Advanced Ceramics; and (5) Specialty Compounds.

Our net sales consist of sales of our products, net of sales discounts, product returns and allowances. In addition, net sales include shipping and handling costs billed to customers. Sales are primarily made on a purchase order basis.

Our cost of products sold consists of variable and fixed components. Our variable costs are proportional to volume and consist principally of raw materials, packaging and related supplies, certain energy costs, and certain distribution costs including inbound, outbound, and internal shipping and transfer costs. Our fixed costs are not significantly impacted by production volume and consist principally of certain fixed manufacturing costs and other distribution network costs, including warehousing. Fixed manufacturing costs comprise headcount-related costs and overhead, including depreciation, periodic maintenance costs, purchasing and receiving costs, inspection costs and certain energy costs.

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Our selling, general and administrative expenses include research and development costs, sales and marketing, divisional management expenses and corporate services including cash management, legal, benefit plan administration and other administrative and professional services.

We are focused on growth, productivity, cost reduction, margin expansion, bolt-on acquisitions, divestment of non-core businesses and debt reduction. In connection with this focus, among other things:

- We have cut costs, reduced overhead and eliminated duplicative positions in both acquired and existing businesses. In 2007, we closed two U.K. facilities acquired in an October 2006 acquisition by our Specialty Compounds segment. We also implemented other restructuring measures in our other segments, including the closure of our Baulking, U.K. facility in our Clay-based Additives business;
- We acquired the global color pigments business of Elementis plc in August 2007 that was included in our Color Pigments and Service business within our Performance Additives segment. In August 2008, we acquired Holliday Pigments, which was also included in our Color Pigments and Service business. In addition, we acquired Nalco's Finishing Technologies business in September 2008, which was included in our Specialty Chemicals segment;
- We completed the Titanium Dioxide Pigments venture with Kemira in September 2008. See Note 4, Acquisitions, for further details;
- We completed the sale of our Groupe Novasep segment in January 2007 and our United States wafer reclaim business in February 2007. In December 2007, we completed the sale of our Electronics business, excluding our European wafer reclaim business and in October 2008, we completed the sale of our pool and spa chemicals business; and
- In March 2008, we implemented a restructuring plan in our Color Pigments and Services business in connection with the business acquired from Elementis plc which includes the reorganization and relocation of its North American Finance and IT services and the closure of three manufacturing facilities by the end of 2008.



## Factors Which Affect Our Results of Operations

### Our Markets

Because the businesses in our segments generally serve many unrelated end-use markets, we discuss the principal market conditions on a segment basis rather than a consolidated basis. The principal market conditions in our segments and regions in which we operate that impacted our results of operations during the periods presented include the following:

#### *Specialty Chemicals*

- Demand for Surface Treatment products in our Specialty Chemicals segment generally follows the activity levels of metal processing manufacturers, including the automotive supply, steel and aerospace industries. Sales growth in the Surface Treatment business occurred in 2007 and has continued in the first nine months of 2008 in most markets and regions served, especially in the general industrial and European automotive industries. This growth was driven by price and volume increases and the impact of bolt-on acquisitions made in December 2007 and September 2008 that more than offset raw material cost increases. We expect the Surface Treatment business to continue to grow in the remainder of 2008. However, our results could be negatively impacted by a slowdown in the automotive and general industrial markets.
- Demand for our lithium products in the Fine Chemicals business line of our Specialty Chemicals segment is generally driven by demand for lithium carbonate in industrial applications, the aluminum business, glass ceramics, cement and the general demand in China. Sales of lithium products specifically used in life science applications depend on the trends in drug development and growth in pharmaceuticals markets as well as generic competition. Growth in the Fine Chemicals business occurred in 2007 and has continued in the first nine months of 2008 in most market segments, driven by higher sales volumes of lithium specialties and price increases for lithium products. Growth in the Fine Chemicals business is expected to continue in most lithium applications for the remainder of 2008.

#### *Performance Additives*

- Generally, a trend towards the increased use of colored concrete products in the North American construction market has historically had a positive effect on our Color Pigments and Services business line. However, a general slowdown in the construction market negatively impacted North American construction sales in 2007. As a result of this continued slowdown, North American volumes were lower in the first nine months of 2008 and are expected to continue to decline throughout the remainder of 2008. However, sales in our Color Pigments and Services business in North America were favorably impacted in the first nine months of 2008 by the acquisition of the global color

pigments business of Elementis plc in August 2007 and the acquisition of Holliday Pigments in August 2008, as well as higher selling prices implemented to help recover raw material and energy cost increases. We expect this trend to continue for the remainder of 2008. Unlike North America, construction volumes in Europe in our Color Pigments and Services business increased slightly in 2007. However, weaker economic conditions in Europe have resulted in a reduction in European construction volumes in the first nine months of 2008 and we expect this trend to continue throughout the remainder of 2008.

- The change in the market to environmentally advanced wood treatment chemical products, such as alkaline copper quaternary, or ACQ, and the phase out of chromated copper arsenate, or CCA, for residential use previously had a positive impact on the Timber Treatment Chemicals business, which is a leading supplier of these higher margin products. However, the market position of ACQ was negatively impacted in 2007 and the first nine months of 2008 by customer shifts to substitute products, a general slowdown in the construction market and the use of wood substitutes. These trends are expected to continue throughout the remainder of 2008. The expiration of the ACQ patent in May 2007 had a negative impact on our results of operations, as one new competitor has entered the market and others may follow. Although we commercialized the next generation non-metallic timber treatment preservatives system (*Ecolife*) in the third quarter of 2007 through our joint venture with Rohm and Haas, this will not have a significant impact in 2008.
- In the Clay-based Additives business, sales were up slightly in 2007 and continued to increase in the first nine months of 2008 as higher oilfield volumes and increased selling prices for coatings and inks were partially offset by lower carbonless applications. We expect sales growth to continue for the remainder of 2008 in oilfield applications.
- Raw material costs have increased in general in the Performance Additives segment. In the Color Pigments and Services and Clay-based Additives businesses, selling price increases helped offset the increases in raw material and energy costs, specifically iron oxide for Color Pigments and Services and quaternary amine ( quat ) for Clay-based Additives. The Timber Treatment Chemicals business continues to experience high costs for monoethanolamine ( MEA ). Selling price increases were implemented in 2007 and were essentially maintained in the first nine months of 2008 to partially offset higher MEA costs. Our ability to pass on additional selling price increases throughout 2008 is uncertain in these businesses.

#### *Titanium Dioxide Pigments*

- Demand for our titanium dioxide products in anatase grade is driven mainly by demand in the synthetic fiber industry, while demand for titanium dioxide products in rutile grade and our functional additives is driven by demand in the coatings, cosmetics, pharmaceutical, food, paper and plastics industries. Market conditions, including pricing pressure and current industry overcapacity, have continued to negatively impact this segment. Volumes and selling prices in the fiber anatase business decreased in 2007 and continued to decline in the first nine months of 2008. We expect this trend to continue for the remainder of 2008. While sales of titanium dioxide products in rutile grade were up slightly in 2007 on increased volumes, sales of these products were down in the first nine months of 2008 due to lower volumes and selling prices and are expected to be lower for the remainder of 2008. Our functional additives business increased in 2007 on higher selling prices and volumes, but was down in the first nine months of 2008 on lower volumes. We expect sales in the functional additives business to decline for the remainder of 2008.

- As discussed in Note 4, Acquisitions, we completed the formation of a venture with Kemira on September 1, 2008 that focuses on producing and marketing specialty titanium dioxide pigments for the synthetic fiber, packaging inks, cosmetics, pharmaceutical and food industries.

#### *Advanced Ceramics*

- Demand for our ceramic medical devices is mainly tied to the aging population in Europe and the United States. Although the volume of our products used in medical device applications sold experienced double-digit growth each year from 2001 through 2005, in 2006 some customers in the U.S. reduced their demand due to high inventory levels and delayed approvals resulting in lower volumes. However, sales of our medical device applications increased in 2007 on higher volumes and continued to increase in the first nine months of 2008. We expect this trend to continue throughout the remainder of 2008.

- Despite the negative impact of pricing pressure from Asian competitors, sales of ceramic products for use in cutting tool products were higher in 2007 and in the first nine months of 2008 due to volume increases and new customer projects. However, volumes of cutting tool applications are expected to be lower for the remainder of 2008. Sales of mechanical systems and applications were up in 2007, but were lower in the first nine months of 2008 on decreased volumes and are expected to continue to decline throughout 2008. Sales in our electronic products business were lower in 2007 primarily on decreased volumes and continued to decrease in the first nine months of 2008 on lower selling prices and volumes. We expect this trend to continue throughout this year. Sales of our multi-functional applications were higher in 2007 from increased volumes, but were down in the first nine months of 2008 from lower selling prices and are expected to decline for the remainder of 2008 on lower volumes.

#### *Specialty Compounds*

- Our largest product line in the Specialty Compounds segment is wire and cable compounds. Sales within this product line are dependent upon the telecommunications market and related sectors, specifically demand for high-end voice and data communication wire and cable, for which our Specialty Compounds segment is a significant provider of sheathing materials. Newly developed non-halogen products for wire and cable data communication, military and other applications have expanded business in North America for those applications and created opportunities in Europe. Although sales of wire and cable products were up slightly in 2007, sales growth was due to the acquisition of the Megolon division of Scapa Group, plc., the wire and cable business was negatively impacted by a general downturn in the wire and cable market. As a result of continued weakness in the wire and cable market, volumes of wire and cable products were down slightly in the first nine months of 2008 and expected to decline for the remainder of 2008.
- Most of the other end-use markets for which Specialty Compounds products are used generally track growth of gross domestic product, but many are also application specific, such as automotive. We are focusing more of our efforts towards increasing high margin specialty products, in particular, thermoplastic elastomers, and less of our efforts in automotive and footwear. Our net sales in consumer/industrial thermoplastic elastomers were up in 2007 and in the first nine months of 2008, and are expected to be up slightly for the remainder of 2008. Net sales of regulated packaging were lower in 2007 and the first nine months of 2008 and are expected to continue to decline for the remainder of 2008.
- Raw material prices for polyvinyl chloride ( PVC ) resin, plasticizers and ammonium octamolybdate, key raw materials used in the production of wire and cable products, were slightly lower in 2007, but were up in the first nine months of 2008. We expect the prices of PVC resin and plasticizers to decrease throughout the remainder of 2008.

#### **Global Exposure**

We operate a geographically diverse business. Of our 2007 net sales, 52% were shipments to Europe, 31% to North America (predominantly the United States) and 17% to the rest of the world. For a geographic description of the origin of our net sales and location of our long-lived assets, see Note 4, Segment Information in our 2007 Form 10-K.

We estimate that we sold to customers in more than 60 countries during this period. Currently, we serve our diverse and extensive customer base with 95 manufacturing facilities in 25 countries. Consequently, we are exposed to global economic and political changes, particularly currency fluctuations that could impact our profitability and demand for our products.

Our sales and production costs are mainly denominated in U.S. dollars or euros. Our results of operations and financial condition have been historically impacted by the fluctuation of the euro against our reporting currency, the U.S. dollar. For the three and nine months ended September 30, 2008, the average exchange rate of the euro against the U.S. dollar was higher compared to the same period in 2007. As a result, our net sales, gross profit and operating income were positively impacted. Historically, however, our operating margins have not been significantly impacted by currency fluctuations because, in general, sales and costs of products sold are generated or incurred in the same currency, subject to certain exceptions.

### **Raw Materials**

Raw materials constituted approximately 54% of our 2007 cost of products sold. We have a broad raw material base, with the cost of no single raw material representing more than 3% of our cost of products sold in 2007. Nonetheless, the significant price fluctuations our raw materials have experienced in the past during periods of high demand have had an adverse impact on our results of operations. We cannot accurately predict the impact of any future price increases for raw materials or any raw material shortages on our business as a whole or in specific geographic regions. In addition, we may not be able to pass on raw material price increases to our customers. See details of our ten most significant raw materials (in terms of dollars) in 2007 in Item 1, Business Raw Materials in our 2007 Form 10-K.

### **Energy Costs**

In 2007, energy purchases represented approximately 5% of our cost of products sold. However, within certain business lines, such as our Titanium Dioxide Pigments segment and the Color Pigments and Services and Clay-based Additives businesses of our Performance Additives segment, energy costs are more significant. The cost of products sold for certain of our businesses, including Color Pigments and Services and Clay-based Additives, increases when the price of natural gas in North America rises. Natural gas prices in North America were relatively stable in 2007, but were higher during the first nine months of 2008. Natural gas prices in Europe, where our Titanium Dioxide Pigments segment is located, have historically been relatively stable, although prices were higher in 2007 and in the first nine months of 2008.

### **Income Taxes**

We recorded an income tax provision of \$10.3 million in the third quarter of 2008 on income from continuing operations before taxes and minority interest of \$4.5 million. The income tax provision in the third quarter of 2008 was negatively impacted by the absence of a tax benefit for the Company's domestic losses as a result of a full valuation allowance. This domestic loss is primarily due to foreign exchange losses and mark-to-market losses on derivative instruments. This was partially offset by the allocation of tax benefits to continuing operations.

In the third quarter of 2008, the worldwide valuation allowance decreased by \$37.3 million. This was due to a \$53.4 million reduction in domestic losses in other comprehensive income, a decrease of \$2.3 million due to the offset of net operating losses against uncertain tax benefit liabilities, partially offset by a \$18.4 million deferred tax increase associated with the Company's domestic earnings. Of the \$37.3 million

decrease in the valuation allowance for the third quarter of 2008, \$18.4 million impacted the tax provision.

### **Acquisitions**

During the periods presented, we made acquisitions pursuant to our business strategy of achieving profitable growth. See Note 4, Acquisitions, for further details.

### **Special Charges and Credits**

During the periods presented, we incurred certain special charges that include systems/organization establishment expenses, restructuring and related charges, foreign exchange gains and losses and inventory write-up charges. See Items excluded from Adjusted EBITDA section in Note 3, Segment Information, for a discussion of special charges and credits recorded in the three and nine months ended September 30, 2008 and 2007.

### **Special Note Regarding Non-GAAP Financial Measures**

A non-GAAP financial measure is generally defined by the SEC as one that purports to measure historical or future financial performance, financial position or cash flows but excludes or includes amounts that would not be so adjusted in the most comparable U.S. GAAP measure. From time to time in this management's discussion and analysis, we disclose non-GAAP financial measures, primarily Adjusted EBITDA, as defined below.

### **Definition of Adjusted EBITDA**

The presentation of consolidated Adjusted EBITDA contained in this report is calculated using the definition set forth in the senior

secured credit agreement as a basis and reflects management's interpretations thereof. Adjusted EBITDA, which is referred to under the senior secured credit agreement as Consolidated EBITDA, is defined in the senior secured credit agreement as consolidated earnings (which, as defined in the senior secured credit agreement, equals income (loss) before the deduction of income taxes of Rockwood Specialties Group, Inc. and the Restricted Subsidiaries (as such term is defined in the senior secured credit agreement), excluding extraordinary items) plus:

- interest expense;
- depreciation expense;
- amortization expense, including amortization of deferred financing fees;
- extraordinary losses and non-recurring charges;
- non-cash charges;
- losses on asset sales;
- restructuring charges or reserves (including severance, relocation costs and one-time compensation charges and costs relating to the closure of facilities);
- expenses paid by us or any of our subsidiaries in connection with the Dynamit Nobel Acquisition, the senior secured credit agreement, the granting of liens under the security documents (as such term is defined in the senior secured credit agreement), the indenture governing the 2014 Notes and the offering of the 2014 Notes and any other related transactions;
- any expenses or charges incurred in connection with any issuance of debt or equity securities;
- any fees and expenses related to permitted acquisitions;
- any deduction for minority interest expense; and
- items arising in connection with CCA litigation related to our Timber Treatment Chemicals business of our Performance Additives segment;

less:

- extraordinary gains and non-recurring gains;
- non-cash gains; and
- gains on asset sales,

in all cases, subject to certain exclusions.

For presentation purposes within this report, we use the computation set forth in our senior secured credit agreement as a basis which reflects management's interpretations thereof. Management has determined that stock-based compensation costs, which are non-cash charges, will not be an adjustment in calculating Adjusted EBITDA as these costs will be an ongoing recurring cost to the Company. These costs are recorded in selling, general and administrative expenses in the Consolidated Statements of Operations. Specifically, calculation of Adjusted EBITDA according to the indenture underlying our 2014 Notes excludes certain adjustments prescribed within the senior secured credit agreement. Given that borrowings under the senior secured credit agreement are secured by most of our assets and given that the calculation does not materially differ from the calculation of Adjusted EBITDA for performance measurement purposes, we believe this is the most appropriate computation of Adjusted EBITDA to present.

### **Management's Uses**

We use Adjusted EBITDA on a consolidated basis to assess our operating performance. We believe this financial measure on a consolidated basis is helpful in highlighting trends in our overall business because the items excluded in calculating Adjusted EBITDA have been deemed by management to have little or no bearing on our day-to-day operating performance. It is also the most significant criterion in our calculation of performance-based cash bonuses and our determination of whether certain performance-based stock options and restricted stock units vest, all of which are tied to Adjusted EBITDA targets.

We also use Adjusted EBITDA on a consolidated basis as a liquidity measure. We believe this financial measure on a consolidated basis is important in analyzing our liquidity because our senior secured credit agreement and indenture governing the 2014 Notes contain financial covenants that are determined based on Adjusted EBITDA. These covenants are material terms of these agreements, because they govern substantially all of our long-term debt, which in turn represents a substantial portion of our capitalization. Non-compliance with these financial covenants under our senior secured credit facilities—our maximum total leverage ratio and our minimum interest coverage ratio, in particular—could result in the lenders requiring us to immediately repay all amounts borrowed. Any such acceleration could also lead to the noteholders accelerating the maturity of the 2014 Notes. In addition, if we cannot satisfy these financial covenants in the indenture governing the 2014 Notes, we cannot engage in certain activities, such as incurring additional indebtedness or making certain payments. Consequently, Adjusted EBITDA is critical to our assessment of our liquidity.

We also use Adjusted EBITDA on a segment basis as the primary measure used by our chief operating decision maker, our Chief Executive Officer, to evaluate the ongoing performance of our business segments and reporting units. On a segment basis, we define Adjusted EBITDA as operating income excluding depreciation and amortization, certain non-cash gains and charges, certain other special gains and charges determined by our senior management to be non-recurring gains and charges and certain items deemed by our senior management to have little or no bearing on the day-to-day operating performance of our business segments and reporting



units. The adjustments made to operating income directly correlate with the adjustments to net income in calculating Adjusted EBITDA on a consolidated basis pursuant to the senior secured credit agreement, which reflects management's interpretations thereof.

### **Limitations**

Adjusted EBITDA has limitations as an analytical tool, and should not be viewed in isolation and is not a substitute for U.S. GAAP measures of earnings and cash flows. Material limitations associated with making the adjustments to our earnings and cash flows to calculate Adjusted EBITDA, and using this non-GAAP financial measure as compared to the most directly comparable U.S. GAAP financial measures, include:

- the cash portion of interest expense, net, income tax provision (benefit), and restructuring as well as non-recurring charges related to securities issuance, acquisition activities, and systems/organization establishment, generally represent charges (gains) which may significantly affect funds available to use in our operating, investing and financing activities;
- non-operating foreign exchange gains (losses), although not immediately affecting cash used in investing activities, may affect the amount of funds needed to service our debt if those currency impacts remain in place as we meet our future principal repayment obligations; and
- depreciation, amortization, non-cash (gains) charges and impairment charges, though not directly affecting our current cash position, represent the wear and tear and/or reduction in value of the plant, equipment and intangible assets which permit us to manufacture and/or market our products; these items may be indicative of future needs for capital expenditures, for development or acquisition of intangible assets or relevant trends causing asset value changes.

An investor or potential investor may find any one or all of these items important in evaluating our performance, results of operations, financial position and liquidity. Management compensates for the limitations of using non-GAAP financial measures by using them only to supplement our U.S. GAAP results to provide a more complete understanding of the factors and trends affecting our business.

Adjusted EBITDA is not an alternative to net income (loss) or income (loss) from continuing operations before taxes and minority interest or operating income or cash flows from operating activities as calculated and presented in accordance with U.S. GAAP. You should not rely on Adjusted EBITDA as a substitute for any such U.S. GAAP financial measures. We strongly urge you to review the reconciliations of Adjusted EBITDA to U.S. GAAP financial measures and other financial information, in each case included elsewhere in this Annual Report. We also strongly urge you not to rely on any single financial measure to evaluate our business. Our measure of Adjusted EBITDA may not be comparable to those of other companies.

### **Results of Operations**

**Actual Results of Operations**

The following table presents the major components of our operations on an actual basis and Adjusted EBITDA (the reconciliation to net income is set forth in Reconciliation of Net Income to Adjusted EBITDA for the three and nine months ended September 30, 2008 and 2007), including as a percentage of net sales, for the periods presented. See Note 3, Segment Information, for segment information and a reconciliation to income from continuing operations before taxes and minority interest to Adjusted EBITDA on a segment basis.

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(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>Statement of operations data:</b>				
<b>Net sales:</b>				
Specialty Chemicals	\$ 319.5	\$ 261.4	\$ 966.7	\$ 800.2
Performance Additives	223.2	203.7	676.8	590.8
Titanium Dioxide Pigments	140.6	113.8	380.8	334.7
Advanced Ceramics	126.4	111.7	404.9	335.8
Specialty Compounds	68.6	69.8	210.8	210.2
Corporate and other	2.5	2.7	7.8	9.4
Total net sales	880.8	763.1	2,647.8	2,281.1
Gross profit	257.5	237.3	813.3	731.9
	29.2%	31.1%	30.7%	32.1%
Selling, general and administrative expenses	170.3	148.8	512.7	441.7
	19.3%	19.5%	19.4%	19.4%
Restructuring charges, net	3.4	2.9	5.7	8.9
Gain on sale of assets and other	(2.7)	(0.1)	(1.8)	(5.3)
<b>Operating income (loss):</b>				
Specialty Chemicals	60.3	44.7	188.2	153.0
	18.9%	17.1%	19.5%	19.1%
Performance Additives	3.9	22.5	36.9	73.9
	1.7%	11.0%	5.5%	12.5%
Titanium Dioxide Pigments	7.0	11.1	17.4	29.8
	5.0%	9.8%	4.6%	8.9%
Advanced Ceramics	25.6	19.5	84.5	59.9
	20.3%	17.5%	20.9%	17.8%
Specialty Compounds	4.8	5.0	17.4	16.6
	7.0%	7.2%	8.3%	7.9%
Corporate and other	(15.1)	(17.1)	(47.7)	(46.6)
Total operating income	86.5	85.7	296.7	286.6
<b>Other income (expenses):</b>				
Interest expense	(56.3)	(57.0)	(139.7)	(158.6)
Interest income	0.6	1.7	4.2	10.1
Loss on early extinguishment of debt				(18.6)
Refinancing expenses				(0.9)
Foreign exchange (loss) gain, net	(26.5)	7.8	(12.2)	11.3
Other, net	0.2	(0.1)	0.7	(0.1)
<b>Income from continuing operations before taxes and minority interest</b>				
	4.5	38.1	149.7	129.8
Income tax provision	10.3	16.1	50.6	56.8
(Loss) income from continuing operations before minority interest	(5.8)	22.0	99.1	73.0
Minority interest in continuing operations, net of tax	1.0	(2.8)	0.4	(6.2)
Net (loss) income from continuing operations	(4.8)	19.2	99.5	66.8
Income from discontinued operations, net of tax	1.5	5.5	2.9	15.6
Gain on sale of discontinued operations, net of tax				115.7
Minority interest in discontinued operations, net of tax				(0.1)
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
<b>Adjusted EBITDA:</b>				
Specialty Chemicals	\$ 78.8	\$ 58.2	\$ 241.4	\$ 192.8
	24.7%	22.3%	25.0%	24.1%
Performance Additives	28.6	40.8	99.5	119.5
	12.8%	20.0%	14.7%	20.2%
Titanium Dioxide Pigments	23.9	21.8	60.2	60.9
	17.0%	19.2%	15.8%	18.2%
Advanced Ceramics	38.1	30.7	121.5	92.2
	30.1%	27.5%	30.0%	27.5%

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Specialty Compounds	7.9	7.8	26.7	25.4
	11.5%	11.2%	12.7%	12.1%
Corporate and other	(14.1)	(13.8)	(41.8)	(41.5)
Total Adjusted EBITDA (a)	\$ 163.2	\$ 145.5	\$ 507.5	\$ 449.3

(a) This amount does not include \$2.7 million and \$5.1 million of Adjusted EBITDA for the three and nine months ended September 30, 2008, respectively, and \$2.2 million and \$5.9 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the pool and spa chemicals business sold in October 2008. This amount does not include \$9.6 million and \$27.3 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the Electronics business sold on December 31, 2007 and \$1.8 million of Adjusted EBITDA for the nine months ended September 30, 2007 from the former Groupe Novasep segment sold on January 9, 2007.

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The following table presents the changes in the major components of our operations on a historical basis in dollars and percentages:

**Change: Three months ended September 30, 2008 versus 2007**      **Change: Nine months ended September 30, 2008 versus 2007**

(\$ in millions)	Total	% Change	Constant Currency Effect (a)	Constant Currency Basis	Total	% Change	Constant Currency Effect (a)	Constant Currency Basis
<b>Statement of operations data:</b>								
<b>Net sales:</b>								
Specialty Chemicals	\$ 58.1	22.2%	\$ 17.1	\$ 41.0	\$ 166.5	20.8%	\$ 76.1	\$ 90.4
Performance Additives	19.5	9.6	2.0	17.5	86.0	14.6	14.8	71.2
Titanium Dioxide Pigments	26.8	23.6	9.7	17.1	46.1	13.8	41.4	4.7
Advanced Ceramics	14.7	13.2	10.2	4.5	69.1	20.6	44.4	24.7
Specialty Compounds	(1.2)	(1.7)	(0.7)	(0.5)	0.6	0.3	1.6	(1.0)
Corporate and other	(0.2)	(7.4)	0.2	(0.4)	(1.6)	(17.0)	0.9	(2.5)
Total net sales	117.7	15.4	38.5	79.2	366.7	16.1	179.2	187.5
Gross profit	20.2	8.5	13.6	6.6	81.4	11.1	61.7	19.7
Selling, general and administrative expenses	21.5	14.4	8.1	13.4	71.0	16.1	37.3	33.7
Restructuring charges	0.5			0.5	(3.2)			(3.2)
Gain on sale of assets and other	(2.6)			(2.6)	3.5			3.5
Total operating expenses	19.4	12.8	8.1	11.3	71.3	16.0	37.3	34.0
<b>Operating income (loss):</b>								
Specialty Chemicals	15.6	34.9	2.5	13.1	35.2	23.0	12.0	23.2
Performance Additives	(18.6)	(82.7)	0.2	(18.8)	(37.0)	(50.1)	0.9	(37.9)
Titanium Dioxide Pigments	(4.1)	(36.9)	0.3	(4.4)	(12.4)	(41.6)	1.6	(14.0)
Advanced Ceramics	6.1	31.3	2.4	3.7	24.6	41.1	10.5	14.1
Specialty Compounds	(0.2)	(4.0)	0.2	(0.4)	0.8	4.8	0.4	0.4
Corporate and other	2.0	11.7	(0.1)	2.1	(1.1)	(2.4)	(1.0)	(0.1)
Total	0.8	0.9	5.5	(4.7)	10.1	3.5	24.4	(14.3)
<b>Other income (expenses):</b>								
Interest expense	0.7	(1.2)	0.2	0.5	18.9	(11.9)	1.1	17.8
Interest income	(1.1)	(64.7)		(1.1)	(5.9)	(58.4)		(5.9)
Loss on early extinguishment of debt					18.6			
Refinancing expenses					0.9			
Foreign exchange (loss) gain, net	(34.3)				(23.5)			
Other, net	0.3				0.8			
<b>Income from continuing operations before taxes and minority interest</b>								
Specialty Chemicals	9.6				23.1			
Performance Additives	(20.9)				(48.4)			
Titanium Dioxide Pigments	(4.9)				(15.3)			
Advanced Ceramics	5.6				23.9			
Specialty Compounds	(0.5)				1.8			
Corporate and other	(22.5)				34.8			
Total	(33.6)				19.9			
Income tax provision	(5.8)				(6.2)			
(Loss) income from continuing operations before minority interest	(27.8)				26.1			
Minority interest in continuing operations, net of tax	3.8				6.6			
Net (loss) income from continuing operations	(24.0)				32.7			
Income from discontinued operations, net of tax	(4.0)				(12.7)			
Gain on sale of discontinued operations, net of tax					(115.7)			
Minority interest in discontinued operations, net of tax					0.1			
Net (loss) income	\$ (28.0)				\$ (95.6)			
<b>Adjusted EBITDA:</b>								
Specialty Chemicals	\$ 20.6	35.4%	\$ 3.5	\$ 17.1	\$ 48.6	25.2%	\$ 15.9	\$ 32.7

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Performance Additives	(12.2)	(29.9)	0.6	(12.8)	(20.0)	(16.7)	3.0	(23.0)
Titanium Dioxide Pigments	2.1	9.6	1.7	0.4	(0.7)	(1.1)	6.4	(7.1)
Advanced Ceramics	7.4	24.1	3.4	4.0	29.3	31.8	14.7	14.6
Specialty Compounds	0.1	1.3	0.1		1.3	5.1	0.5	0.8
Corporate and other	(0.3)	(2.2)	(0.2)	(0.1)	(0.3)	(0.7)	(0.9)	0.6
<b>Total Adjusted EBITDA</b>	<b>\$ 17.7</b>	<b>12.2%</b>	<b>\$ 9.1</b>	<b>\$ 8.6</b>	<b>\$ 58.2</b>	<b>13.0%</b>	<b>\$ 39.6</b>	<b>\$ 18.6</b>

(a) The constant currency effect is the translation impact calculated based on the change in the applicable rate, primarily the euro, to the U.S. dollar exchange rate for the applicable period.

*Three months ended September 30, 2008 compared to three months ended September 30, 2007*

### Overview

Net sales increased \$117.7 million in the third quarter of 2008 compared with the same period in the prior year primarily due to the positive impact of currency changes of \$38.5 million, the impact of bolt-on acquisitions and increased selling prices of \$36.4 million. Higher volumes in our Specialty Chemicals and Advanced Ceramics segments also had a favorable impact on net sales. See further discussion by segment below.

Operating income and Adjusted EBITDA also increased in the third quarter of 2008 compared with the same period in the prior year due to the positive impact of currency changes and the sales increases noted above. Operating income and Adjusted EBITDA were negatively impacted by higher raw material and energy costs in most businesses.

Net income from continuing operations decreased \$24.0 million compared with the same period in the prior year due to foreign exchange losses on financing activities recorded in the third quarter of 2008 and the reasons noted above.

Income from discontinued operations, net of tax was \$1.5 million in the third quarter of 2008 and was comprised of income from operating the pool and spa chemicals business that was sold in October 2008. Income from discontinued operations, net of tax was \$5.5 million in the third quarter of 2007 and was comprised of income from operating the Electronics business, excluding the European wafer reclaim business, that was sold in December 2007 and the pool and spa chemicals business.

Net income decreased \$28.0 million in the third quarter of 2008 compared with the same period in the prior year due to the reasons noted above.

#### **Net sales**

*Specialty Chemicals.* Net sales increased \$58.1 million over the prior year, including the positive impact of currency changes of \$17.1 million. In the Fine Chemicals business, higher selling prices of lithium products, as well as increased volumes, had a favorable impact on net sales. Net sales in the Surface Treatment business were favorably impacted by higher selling prices, increased volumes in all markets, particularly in general industrial applications, and the impact of bolt-on acquisitions in December 2007 and September 2008.

*Performance Additives.* Net sales increased \$19.5 million over the prior year primarily due to acquisitions in August 2007 and 2008. Also, increased selling prices in our Color Pigments and Services and Clay-based Additives businesses and the positive impact of currency changes of \$2.0 million were partially offset by lower volumes of construction-related products in our Color Pigments and Services and Timber Treatment Chemicals businesses.

*Titanium Dioxide Pigments.* Net sales increased \$26.8 million over the prior year due to the completion of the venture with Kemira on September 1, 2008 and positive impact of currency changes of \$9.7 million, partially offset by lower volumes and selling prices of titanium dioxide products, primarily commodity grade.

*Advanced Ceramics.* Net sales increased \$14.7 million over the prior year primarily due to the positive impact of currency changes of \$10.2 million and increased volumes of medical applications. This was partially offset by volume declines in mechanical systems and mechanical applications.

*Specialty Compounds.* Net sales decreased \$1.2 million over the prior year due to lower volumes, particularly in wire and cable and footwear applications and the negative impact of currency changes of \$0.7 million. This was partially offset by increased selling prices.

*Corporate and other.* Net sales decreased \$0.2 million over the prior year primarily due to lower volumes and selling prices in the European wafer reclaim business.

### **Gross profit**

Gross profit increased \$20.2 million over the prior year primarily due to the positive impact of currency changes of \$13.6 million. Sales increases noted above, in particular selling price increases, were partially offset by raw material cost increases, particularly from the impact of higher phosphoric acid and tin costs in our Specialty Chemicals segment, higher iron-oxide costs in our Color Pigments and Services business, higher quat costs in our Clay-based additives business and higher PVC resin and plasticizer costs in our Specialty Compounds segment. We also experienced lower volumes in our Color Pigments and Services, Timber Treatment Chemicals and Titanium Dioxide Pigments businesses. In addition, depreciation and amortization costs were higher in most businesses, in part from the impact of acquisitions. Gross profit as a percentage of net sales decreased to 29.2% in the third quarter of 2008 from 31.1% in the third quarter of 2007.

### **Selling, general and administrative expenses**

Selling, general and administrative expenses, or SG&A, increased \$21.5 million primarily due to increased sales volumes in a few segments, particularly in the Specialty Chemicals and Advanced Ceramics segments, and the impact of currency changes of \$8.1 million. SG&A expenses as a percentage of net sales were 19.3% and 19.5% in the third quarter of 2008 and 2007, respectively.

### **Restructuring charges, net**

We recorded \$3.4 million of restructuring charges in the third quarter of 2008 for restructuring actions in a number of segments primarily for miscellaneous headcount reductions. We recorded \$2.9 million of restructuring charges in the third quarter of 2007 primarily related to headcount reductions and facility closures in the Specialty Chemicals, Performance Additives, Advanced Ceramics and Corporate and other segments. See Note 13, Restructuring Liability, for further details.

### **Gain on sale of assets and other**

We recorded a gain of \$2.7 million in the third quarter of 2008 primarily related to the sale of land that was acquired as part of the



acquisition of Dynamit Nobel in 2004.

### **Operating income**

*Specialty Chemicals.* Operating income increased \$15.6 million over the prior year primarily due to the impact of higher sales in both the Surface Treatment and Fine Chemicals businesses and the positive impact of currency changes of \$2.5 million. This increase was partially offset by higher raw material costs of \$8.8 million, primarily for phosphoric acid and tin, and increased depreciation and amortization costs of \$4.3 million, including the impact of bolt-on acquisitions in December 2007 and September 2008.

*Performance Additives.* Operating income decreased \$18.6 million over the prior year due to the lower sales volumes discussed above, and higher raw material costs of \$16.1 million, particularly iron-oxide costs in the Color Pigments and Services business and higher quat costs in our Clay-based Additives business. Higher depreciation and amortization costs of \$2.8 million primarily due to the acquisitions in August 2007 and 2008 also had an unfavorable impact on operating income. These decreases were partially offset by the sales increases noted above.

*Titanium Dioxide Pigments.* Operating income decreased \$4.1 million over the prior year primarily due to lower sales volumes and selling prices noted above, increased depreciation and amortization costs of \$4.1 million and higher energy costs of \$3.2 million. This was partially offset by increased sales related to the completion of the venture with Kemira on September 1, 2008.

*Advanced Ceramics.* Operating income increased \$6.1 million over the prior year primarily due to the impact of the increased sales volumes noted above, productivity improvements and the positive impact of currency changes of \$2.4 million. This increase was partially offset by lower selling prices.

*Specialty Compounds.* Operating income decreased \$0.2 million over the prior year due to higher raw material costs of \$4.5 million, particularly PVC resin and plasticizer costs, and lower sales volumes. This was partially offset by higher selling prices and lower operating costs.

*Corporate and other.* Operating income increased \$2.0 million primarily related to the sale of land that was acquired as part of the acquisition of Dynamit Nobel in 2004.

### **Other income (expenses)**

*Interest expense.* Interest expense decreased \$0.7 million in the third quarter of 2008 compared to the same period in the prior year. The third quarter of 2008 and 2007 included losses of \$10.0 million and \$13.4 million, respectively, representing the movement in the mark-to-market valuation of our interest rate hedging instruments. The remaining interest expense increase of \$2.7 million is primarily due to increased debt levels related to the completion of the Titanium Dioxide Pigments venture with Kemira.

*Interest income.* Interest income decreased \$1.1 million in the third quarter of 2008 compared to the same period in the prior year due to lower average cash balances in the third quarter of 2008 compared to the third quarter of 2007 and lower short-term average rates.

*Foreign exchange, net.* In the third quarter of 2008, we had foreign exchange losses of \$26.5 million compared to foreign exchange gains of \$7.8 million recorded in the same period in the prior year. The foreign exchange loss reported in the third quarter of 2008 is primarily due to the impact of a weaker euro as of September 30, 2008 versus June 30, 2008 related to euro-denominated financing transactions.

#### **Provision for income taxes**

We recorded an income tax provision of \$10.3 million in the third quarter of 2008 on income from continuing operations before taxes and minority interest of \$4.5 million. The income tax provision in the third quarter of 2008 was adversely impacted by the absence of a tax benefit for the Company's domestic losses as a result of a full valuation allowance. These losses were primarily due to foreign exchange losses and mark-to-market losses on derivative instruments. This was partially offset by the allocation of tax benefits to continuing operations. The effective income tax rate was 42.3% for the third quarter of 2007 and was negatively impacted by the absence of a tax benefit for the Company's domestic losses as a result of a full valuation allowance.

#### **Minority interest in continuing operations**

For the three months ended September 30, 2008 and 2007, we recorded minority interest of \$1.0 million and \$(2.8) million. Minority interest represents the minority interest portion of the Viance, LLC joint venture completed in January 2007 between our Timber Treatment Chemicals business and Rohm and Haas Company and the minority interest portion of the Titanium Dioxide Pigments venture completed in September 2008 between our Titanium Dioxide Pigments segment and Kemira. The change from the prior year primarily relates to lower volumes of timber treatment chemicals in the Viance LLC joint venture.

#### **Net (loss) income from continuing operations**

Net loss from continuing operations for the third quarter of 2008 was \$4.8 million as compared to net income from continuing operations of \$19.2 million for the third quarter of 2007 for the reasons described above.

**Income from discontinued operations, net of tax**

Income from discontinued operations, net of tax was \$1.5 million in the third quarter of 2008 from operating the pool and spa chemicals business that was sold in October 2008, compared to \$5.5 million in the third quarter of 2007 due to income from operating the Electronics business, that was sold in December 2007, and the pool and spa chemicals business.

**Net (loss) income**

Net loss for the third quarter of 2008 was \$3.3 million as compared to net income of \$24.7 million for the third quarter of 2007 for the reasons described above.

**Adjusted EBITDA**

*Specialty Chemicals.* Adjusted EBITDA increased \$20.6 million over the prior year primarily due to the impact of higher sales in both the Surface Treatment and Fine Chemicals businesses and the positive impact of currency changes of \$3.5 million. This increase was partially offset by higher raw material costs of \$8.8 million as discussed above.

*Performance Additives.* Adjusted EBITDA decreased \$12.2 million over the prior year due to lower sales volumes and higher raw material costs of \$16.1 million as discussed above. These decreases were partially offset by the selling price increases noted above.

*Titanium Dioxide Pigments.* Adjusted EBITDA increased \$2.1 million over the prior year primarily due to the impact of currency changes of \$1.7 million and the completion of the venture on September 1, 2008. This was partially offset by the lower sales volumes and selling prices noted above and higher energy costs of \$3.2 million.

*Advanced Ceramics.* Adjusted EBITDA increased \$7.4 million over the prior year primarily due to the impact of the increased sales volumes noted above, productivity improvements and the positive impact of currency changes of \$3.4 million. This increase was partially offset by lower selling prices.

*Specialty Compounds.* Adjusted EBITDA increased slightly over the prior year due to the positive impact of foreign currency and lower operating costs. This was partially offset by higher raw material costs of \$4.5 million, particularly PVC resin and plasticizer costs, and lower sales volumes.

***Nine months ended September 30, 2008 compared to nine months ended September 30, 2007***

## Overview

Net sales increased \$366.7 million in the first nine months of 2008 compared with the same period in the prior year primarily due to the positive impact of currency changes of \$179.2 million, the impact of bolt-on acquisitions and increased selling prices of \$76.0 million. Higher volumes in our Specialty Chemicals and Advanced Ceramics segments also had a favorable impact on net sales. See further discussion by segment below.

Operating income and Adjusted EBITDA also increased in the first nine months of 2008 compared with the same period in the prior year due to the positive impact of currency changes and the sales increases noted above. Operating income and Adjusted EBITDA were negatively impacted by higher raw material and energy costs in most businesses.

Net income from continuing operations increased \$32.7 million compared with the same period in the prior year primarily due to lower interest expense due to lower mark-to-market losses on our interest rate hedging instruments, costs of \$18.6 million incurred in 2007 to redeem our 2011 Notes and increased foreign exchange gains.

Income from discontinued operations, net of tax was \$2.9 million in the first nine months of 2008 and was comprised of income from operating the pool and spa chemicals business that was sold in October 2008. In the first nine months of 2007, income from discontinued operations, net of tax was \$15.6 million and was primarily comprised of income from operating the pool and spa chemicals business and the Electronics business, excluding the European wafer reclaim business, which was sold in December 2007.

The gain on sale of discontinued operations, net of tax of \$115.7 million recorded in the first nine months of 2007 is related to the sale of Groupe Novasep in January 2007.

Net income decreased \$95.6 million in the first nine months of 2008 compared with the same period in the prior year due to the reasons noted above.

## Net sales

*Specialty Chemicals.* Net sales increased \$166.5 million over the prior year, including the positive impact of currency changes of \$76.1 million. In the Fine Chemicals business, higher selling prices of lithium products, as well as increased volumes, had a favorable impact on net sales. Net sales in the Surface Treatment business were favorably impacted by higher selling prices, increased volumes

in all markets, particularly in general industrial and European automotive applications, and the impact of bolt-on acquisitions in December 2007 and September 2008.

*Performance Additives.* Net sales increased \$86.0 million over the prior year due to acquisitions in August 2007 and 2008, as well as increased selling prices in our Color Pigments and Services and Clay-based Additives businesses and the positive impact of currency changes of \$14.8 million. This was partially offset by lower volumes of construction-related products in our Color Pigments and Services and Timber Treatment Chemicals businesses.

*Titanium Dioxide Pigments.* Net sales increased \$46.1 million over the prior year due to the positive impact of currency changes of \$41.4 million and the completion of the venture with Kemira on September 1, 2008. This was partially offset by lower volumes and selling prices of titanium dioxide products and lower volumes of functional additives.

*Advanced Ceramics.* Net sales increased \$69.1 million over the prior year primarily due to the positive impact of currency changes of \$44.4 million, increased volumes of medical and cutting tool applications and the impact of a bolt-on acquisition made in April 2007. This was partially offset by lower selling prices and volume declines in mechanical systems and mechanical applications.

*Specialty Compounds.* Net sales increased \$0.6 million over the prior year due to the positive impact of currency changes of \$1.6 million and higher selling prices, partially offset by lower volumes in wire and cable and medical applications.

*Corporate and other.* Net sales decreased \$1.6 million over the prior year primarily due to the sale of our U.S. wafer reclaim business in the first quarter of 2007 and lower volumes and selling prices in the European wafer reclaim business.

## **Gross profit**

Gross profit increased \$81.4 million over the prior year primarily due to the positive impact of currency changes of \$61.7 million and the sales increases noted above, in particular selling price increases. This was partially offset by raw material cost increases, particularly from the impact of higher phosphoric acid and tin costs in our Specialty Chemicals segment, higher iron-oxide and cobalt costs in our Color Pigments and Services business, higher quat costs in our Clay-based additives business and higher PVC resin and plasticizer costs in our Specialty Compounds segment. We also experienced lower volumes in our Color Pigments and Services, Timber Treatment Chemicals and Titanium Dioxide Pigments businesses and higher depreciation and amortization costs in most businesses including the impact of acquisitions. Gross profit as a percentage of net sales decreased to 30.7% for the nine months ended September 30, 2008 from 32.1% for the nine months ended September 30, 2007.

## **Selling, general and administrative expenses**

Selling, general and administrative expenses, or SG&A, increased \$71.0 million over the prior year primarily due to the impact of currency changes of \$37.3 million. Higher SG&A costs were also recorded in a few segments, particularly in Specialty Chemicals and Advanced Ceramics, related to increased sales volumes. SG&A expenses as a percentage of net sales was 19.4% for the nine months ended September 30,

2008 and 2007.

**Restructuring charges, net**

We recorded \$5.7 million of restructuring charges for the nine months ended September 30, 2008 in a number of segments primarily for miscellaneous headcount reductions. We recorded \$8.9 million of restructuring charges for the nine months ended September 30, 2007 primarily related to miscellaneous headcount reductions and facility closures. See Note 13, Restructuring Liability, for further details.

**Gain on sale of assets**

We recorded a gain of \$1.8 million in the nine months ended September 30, 2008 primarily related to the sale of land that was acquired as part of the acquisition of Dynamit Nobel in 2004. For the nine months ended September 30, 2007, we recorded a gain of \$5.3 million primarily related to the sale of our U.S. wafer reclaim business.

**Operating income**

*Specialty Chemicals.* Operating income increased \$35.2 million over the prior year primarily due to the impact of higher sales in both the Surface Treatment and Fine Chemicals businesses and the positive impact of currency changes of \$12.0 million. This increase was partially offset by higher raw material costs of \$18.2 million, primarily for phosphoric acid and tin, and increased depreciation and amortization costs of \$11.1 million, including the impact of bolt-on acquisitions made in December 2007 and September 2008.

*Performance Additives.* Operating income decreased \$37.0 million over the prior year due to the lower sales volumes discussed above, and higher raw material costs of \$33.2 million, particularly iron-oxide and cobalt costs in the Color Pigments and Services business and higher quat costs in our Clay-based Additives business. Higher depreciation and amortization costs of \$10.5 million primarily due to the acquisitions made in August 2007 and 2008 also had an unfavorable impact on operating income. These decreases were partially offset by the sales increases noted above.

*Titanium Dioxide Pigments.* Operating income decreased \$12.4 million over the prior year primarily due to the lower sales volumes and selling prices noted above, increased depreciation and amortization costs of \$9.4 million and higher energy costs of \$5.3 million. This was partially offset by increased sales related to the completion of the venture with Kemira on September 1, 2008 and the favorable impact of currency changes of \$1.6 million.

*Advanced Ceramics.* Operating income increased \$24.6 million over the prior year primarily due to the impact of the increased sales volumes noted above, the positive impact of currency changes of \$10.5 million and productivity improvements. The impact of a bolt-on acquisition made in April 2007 also had a favorable impact on operating income. This increase was partially offset by lower selling prices and increased depreciation and amortization costs of \$5.8 million primarily related to the acquisition discussed above.

*Specialty Compounds.* Operating income increased \$0.8 million over the prior year due to lower operating costs relating to the closure of a U.K. facility in December 2007 and higher selling prices. This was partially offset by higher raw material costs of \$11.2 million, particularly PVC resin and plasticizer costs, and lower sales volumes.

*Corporate and other.* Operating income decreased \$1.1 million primarily due to additional stock compensation expense related to stock awards made in 2008 and 2007, partially offset by the sale of land that was acquired as part of the acquisition of Dynamit Nobel in 2004.

#### **Other income (expenses)**

*Interest expense.* Interest expense decreased \$18.9 million for the nine months ended September 30, 2008 compared to the same period in the prior year. The nine months ended September 30, 2008 and 2007 included losses of \$6.8 million and \$15.4 million, respectively, representing the movement in the mark-to-market valuation of our interest rate hedging instruments. The remaining interest expense decrease of \$10.3 million is primarily due to the redemption of the 2011 Notes in May 2007 in the aggregate amount of \$273.4 million, partially offset by increased debt levels related to the completion of the Titanium Dioxide Pigments venture.

*Interest income.* Interest income decreased \$5.9 million for the nine months ended September 30, 2008 compared to the same period in the prior year due to lower average cash balances in the first nine months of 2008 compared to the first nine months of 2007 and lower short-term average rates.

*Loss on early extinguishment of debt.* In the second quarter of 2007, we paid a redemption premium of \$14.5 million and wrote off \$4.1 million of deferred financing costs associated with the redemption of the 2011 Notes in May 2007.

*Refinancing expenses.* In March 2007, we expensed \$0.9 million related to the fourth amendment of the senior secured credit agreement resulting in a 50 basis point reduction on our tranche G term loans.

*Foreign exchange, net.* For the nine months ended September 30, 2008, we had foreign exchange losses of \$12.2 million due to the impact of the weaker euro on euro-denominated financing transactions. For the nine months ended September 30, 2007, we had foreign exchange gains of

\$11.3 million related to the impact of the stronger euro.

**Provision for income taxes**

The effective income tax rate for the nine months ended September 30, 2008 was 33.8% and an income tax provision of \$50.6 million was recorded for the nine months ended September 30, 2008. The effective income tax rate compared to the federal statutory rate was negatively impacted by domestic losses which are not tax effected as a result of a full valuation allowance and was positively impacted by favorable European rate changes, geographic earnings mix and an allocation of tax benefits to continuing operations. The effective income tax rate was 43.8% for the nine months ended September 30, 2007.

**Minority interest in continuing operations**

For the nine months ended September 30, 2008 and 2007, we recorded minority interest of \$0.4 million and \$(6.2) million. Minority interest represents the minority interest portion of the Viance, LLC joint venture completed in January 2007 between our Timber Treatment Chemicals business and Rohm and Haas Company and the minority interest portion of the Titanium Dioxide Pigments venture completed in September 2008 between our Titanium Dioxide Pigments segment and Kemira. The change from the prior year primarily relates to lower volumes of timber treatment chemicals in the Viance LLC joint venture.

**Net income from continuing operations**

Net income from continuing operations for nine months ended September 30, 2008 was \$99.5 million as compared to net income from continuing operations of \$66.8 million for the same period in the prior year for the reasons described above.

**Income from discontinued operations, net of tax**

Income from discontinued operations, net of tax was \$2.9 million for the nine months ended September 30, 2008 from operating the pool and spa chemicals business that was sold in October 2008, compared to \$15.6 million for the nine months ended



September 30, 2007, due to income from operating the Electronics business, that was sold in December 2007 and the pool and spa chemicals business.

**Gain on sale of discontinued operations, net of tax**

The gain on sale of discontinued operations, net of tax, of \$115.7 million recorded for the nine months ended September 30, 2007 is related to the sale of Groupe Novasep in January 2007.

**Minority interest in discontinued operations**

Minority interest in discontinued operations represents the minority interest portion of Groupe Novasep's net income for the nine months ended September 30, 2007.

**Net income**

Net income for the nine months ended September 30, 2008 was \$102.4 million as compared to net income of \$198.0 million for the nine months ended September 30, 2007 for the reasons described above.

**Adjusted EBITDA**

*Specialty Chemicals.* Adjusted EBITDA increased \$48.6 million over the prior year primarily due to the impact of higher sales in both the Surface Treatment and Fine Chemicals businesses and the positive impact of currency changes of \$15.9 million. This increase was partially offset by higher raw material costs of \$18.2 million as discussed above.

*Performance Additives.* Adjusted EBITDA decreased \$20.0 million over the prior year due to lower sales volumes and higher raw material costs of \$33.2 million as discussed above. These decreases were partially offset by the sales increases noted above.

*Titanium Dioxide Pigments.* Adjusted EBITDA decreased \$0.7 million over the prior year primarily due to the lower sales volumes and selling prices noted above and higher energy costs of \$5.3 million, partially offset by the positive impact of currency changes of \$6.4 million and the completion of the Titanium Dioxide Pigments venture with Kemira.

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*Advanced Ceramics.* Adjusted EBITDA increased \$29.3 million over the prior year primarily due to the impact of the increased sales volumes noted above, productivity improvements and the positive impact of currency changes of \$14.7 million. The impact of a bolt-on acquisition made in April 2007 also had a favorable impact on Adjusted EBITDA. This increase was partially offset by lower selling prices.

*Specialty Compounds.* Adjusted EBITDA increased \$1.3 million primarily due to lower operating costs relating to the closure of a U.K. facility in December 2007 and higher selling prices. This was partially offset by higher raw material costs of \$11.2 million as discussed above and lower sales volumes.

**Reconciliation of Net (Loss) Income to Adjusted EBITDA**

Because we view Adjusted EBITDA on both a consolidated basis and segment basis as an operating performance measure, we use net income as the most comparable U.S. GAAP measure on a consolidated basis. The following table, which sets forth the applicable components of Adjusted EBITDA, presents a reconciliation of net income to Adjusted EBITDA on a consolidated basis:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net (loss) income	\$ (3.3)	\$ 24.7	\$ 102.4	\$ 198.0
Income from discontinued operations, net of tax	(1.5)	(5.5)	(2.9)	(15.6)
Gain on sale of discontinued operations, net of tax				(115.7)
Minority interest in discontinued operations, net of tax				0.1
Net (loss) income from continuing operations	(4.8)	19.2	99.5	66.8
Income tax provision	10.3	16.1	50.6	56.8
Minority interest in continuing operations, net of tax	(1.0)	2.8	(0.4)	6.2
Income from continuing operations before taxes and minority interest	4.5	38.1	149.7	129.8
Interest expense (a)	56.3	57.0	139.7	158.6
Interest income	(0.6)	(1.7)	(4.2)	(10.1)
Depreciation and amortization	65.6	52.6	190.6	152.6
Restructuring and related charges	3.4	2.9	5.7	8.9
Systems/organization establishment expenses	3.7	0.6	7.1	1.8
Cancelled acquisition and disposal costs	0.2	2.0	0.9	2.8
Inventory write-up charges	3.7	2.7	4.2	2.8
Refinancing expenses				0.9
Loss on early extinguishment of debt				18.6
Gain on sale of assets and other	(2.7)	(0.1)	(1.8)	(5.3)
Acquired in-process research and development	2.8		2.8	
Foreign exchange loss (gain)	26.5	(7.8)	12.2	(11.3)
Other	(0.2)	(0.8)	0.6	(0.8)
Total Adjusted EBITDA (b)	\$ 163.2	\$ 145.5	\$ 507.5	\$ 449.3

(a) Includes losses of \$10.0 million and \$13.4 million for the three months ended September 30, 2008 and 2007, respectively, and losses of \$6.8 million and \$15.4 million for the nine months ended September 30, 2008 and 2007, respectively, representing the movement in the mark-to-market valuation of the Company's interest rate and cross-currency hedging instruments.

(b) This amount does not include \$2.7 million and \$5.1 million of Adjusted EBITDA for the three and nine months ended September 30, 2008, respectively, and \$2.2 million and \$5.9 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the pool and spa chemicals business sold in the October 2008. In addition, this amount does not include \$9.6 million and \$27.3 million of Adjusted EBITDA for the three and nine months ended September 30, 2007, respectively, from the Electronics business sold on December 31, 2007 and \$1.8 million of Adjusted EBITDA for the nine months ended September 30, 2007 from the former Groupe Novasep segment sold on January 9, 2007.

## Liquidity and Capital Resources

### Cash Flows

*Operating Activities.* Net cash provided by operating activities was \$251.4 million and \$291.8 million for the nine months ended September 30, 2008 and 2007, respectively. Net cash from operating activities decreased primarily from the higher use of operating cash from working capital changes and the lack of operating cash flows due to the divestiture of the Electronics business, partially offset by higher operating income and lower cash interest expense.

*Investing Activities.* Net cash (used in) provided by investing activities was \$(310.5) million and \$199.2 million for the nine months ended September 30, 2008 and 2007, respectively. Net cash used in investing activities for the nine months ended September 30, 2008 included the acquisitions of Holliday Pigments and Nalco's Finishing Technologies business in 2008. This was partially offset by funds received related to the claim settlement between the Company and GEA Group in the first quarter of 2008. See Note 6, "Goodwill," for further details. Net cash provided by investing activities for the nine months ended September 30, 2007 included proceeds received in the first quarter of 2007 from the sale of the Groupe Novasep segment and the formation of the Viance, LLC joint venture.

*Financing Activities.* Net cash provided by (used in) financing activities was \$115.2 million and \$(403.5) million for the nine months

ended September 30, 2008 and 2007, respectively. For the nine months ended September 30, 2008, net cash provided by financing activities included \$362.5 million related to the financing of the Titanium Dioxide Pigments venture, partially offset by the payment of assumed debt to the minority shareholder of the Titanium Dioxide Pigments venture of \$141.4 million. For the nine months ended September 30, 2007, net cash used in financing activities included the payment of our 10 5/8% Senior Subordinated Notes due in 2011 in the aggregate principal amount of \$273.4 million and related redemption premiums of \$14.5 million.

## Liquidity

Our primary source of liquidity has been and will continue to be cash generated from the operations of our subsidiaries. Events that have occurred in 2008 that have had an impact on our liquidity include:

- In March 2008, we received 18.8 million (\$29.1 million) from GEA Group and GEA North America for the settlement of all existing and future non-tax related claims resulting from the sale and purchase agreement entered into in connection with the Dynamit Nobel Acquisition in April 2004.
- In the third quarter of 2008, we acquired Holliday Pigments for approximately 46.0 million (\$68.6 million using an August 11, 2008 exchange rate of 1.4909) and Nalco's Finishing Technologies business for approximately \$75.0 million.
- In September 2008, we completed the Titanium Dioxide Pigments venture with Kemira. The venture's acquisition of the shares of the Rockwood and Kemira entities was facilitated by the borrowings under a term loan of 250.0 million (\$362.5 million using a September 3, 2008 exchange rate of 1.4498). The venture made a payment of 97.5 million (\$141.4 million using a September 3, 2008 exchange rate) to the venture's minority shareholder.

In addition, the venture entered into a 30.0 million (\$42.3 million) revolving credit facility to finance its operations and has assumed debt of 25.2 million (\$35.5 million) from Kemira.

- In October 2008, we sold the pool and spa chemicals business and received approximately \$124.0 million in cash.

Our primary liquidity requirements are working capital, debt service, capital expenditures and acquisitions. Our debt service requirements and other contractual obligations and commitments over the next several years are significant and are substantially higher than historical amounts. We believe that based on current conditions in our industry and markets, our cash reserves, cash flows from operations and borrowings available under our revolving credit facility will be adequate sources of liquidity for the remainder of 2008. However, a prolonged economic downturn or recession may have a material adverse impact on our future cash flows from operations and our liquidity. If these sources are insufficient to fund our liquidity needs, we may be forced to use other means available to us, such as reduce or delay capital expenditures or other cost cutting measures or seek additional sources of capital. In addition, any future major acquisitions, business combinations or other such events may require us to seek additional capital resources, such as through additional borrowings, equity issuances or other sources, to satisfy our liquidity needs. The recent unprecedented adverse conditions in the global capital and credit markets may limit our ability to secure capital or obtain it on terms and conditions that are acceptable to us. We cannot predict with any certainty the impact of this or any further disruption in these markets

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or our ability to access these markets in the future. See Item 1, Business, in our 2007 Form 10-K and Item 1A, Risk Factors in this Form 10-Q.

In addition, our liquidity may be materially and adversely impacted due to funding obligations related to certain pension plans. We have several pension plans located in Germany, Finland, the United Kingdom and the United States, which have been adversely impacted by market conditions. For example, based upon recent investment performance of pension assets in a pension plan covering the majority of our German employees, we expect we will have to make a significant payment to the plan via a one-time payment and/or long-term funding arrangement in late 2008. However, this could change significantly based on the fourth quarter investment performance of the pension plan and the future performance of the pension plan assets. Any further deterioration of the capital markets or returns available in such markets may materially and adversely impact our pension plan assets and increase our funding obligations for one or more of these plans and adversely impact our liquidity. We cannot predict the impact of this or any further market disruption on our pension funding obligations.

As of September 30, 2008, we had actual total indebtedness of \$2,833.9 million. The revolving credit facility under the senior secured credit facilities provided for additional borrowings of up to \$225.4 million as of September 30, 2008. There were no outstanding borrowings under this revolving credit facility as of September 30, 2008. The revolving credit facility under the Titanium Dioxide Pigments venture facility provided for additional borrowings of up to 30.0 million (\$42.3 million). As of September 30, 2008, there were no outstanding borrowings under this revolving credit facility.

As of September 30, 2008, we had cash and cash equivalents of \$410.3 million primarily from cash from operations and the net cash proceeds received from the sale of the Electronics business in December 2007, less cash used for certain selective acquisitions.

*Senior secured credit facilities.* The senior secured credit facilities, as amended, consist of:

- tranche A-1 term loans in an aggregate principal amount of 22.8 million (\$32.2 million) and tranche A-2 term loans in an aggregate principal amount of 99.4 million (\$140.1 million), each maturing on July 30, 2011 and bearing interest at Adjusted EURIBOR plus 1.75%;
- tranche E term loans in an aggregate principal amount of \$1,104.9 million, maturing on July 30, 2012 and bearing interest at the Company's option of either (i) Adjusted LIBOR plus 1.50% or (ii) ABR plus 0.75%. For the three months ended

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September 30, 2008, we have elected to use option (i) Adjusted LIBOR plus 1.50%;

- tranche G term loans in an aggregate principal amount of 265.2 million (\$373.7 million) maturing on July 30, 2012 and bearing interest of Adjusted LIBOR plus 1.75%; and

- a revolving credit facility in an aggregate principal amount of \$250.0 million maturing on July 30, 2010, bearing interest at the Company's option of either (i) Adjusted LIBOR plus 1.75% or (ii) ABR plus 1.00%. As of September 30, 2008, we had no borrowings outstanding under this facility and had outstanding letters of credit of \$24.6 million that reduced our availability under the credit facility.

In each case, the interest rates are subject to step-downs determined by reference to a performance test. Adjusted LIBOR is the London inter-bank offered rate adjusted for statutory reserves. ABR is the alternate base rate, which is the highest of Credit Suisse's prime rate and the federal funds effective rate plus 0.5%. Tranche A-1 and A-2 term loans are payable in January and July of each year at escalating percentages of the original principal amount. Tranche E and tranche G term loans are payable in January and July of each year at amounts equal to 0.5% of the principal amount of the former tranche D term loans and tranche F term loans, respectively, with the remainder due at the final maturity date.

The borrowings of our indirect, wholly-owned subsidiaries, Rockwood Specialties Group, Inc. and Rockwood Specialties Limited under the senior secured credit facilities are guaranteed and secured by assets and pledges of capital stock.

In addition to the financial covenants described below under *Covenant Compliance*, the Company's senior secured credit facilities contain various affirmative and restrictive covenants. The restrictive covenants limit our ability to, among other things, incur indebtedness and other liabilities; create liens; merge or consolidate; dispose of assets; make investments; pay dividends and make payments to shareholders; make payments on certain indebtedness or to amend documents related to certain indebtedness and to enter into sale leaseback transactions. In connection with the fourth amendment of our senior secured credit agreement, substantially all of the baskets relating to the above restrictions were reset.

*Covenant compliance.* In addition to the affirmative and restrictive covenants, the senior secured credit agreement contains the following financial covenants that are determined based on our Adjusted EBITDA, which reflects management's interpretations thereof:

- a leverage ratio: for the twelve-month period ended September 30, 2008, net debt (total debt plus capital lease obligations, minus cash up to a maximum of \$100.0 million) to Adjusted EBITDA must be less than 4.75 to 1; for such period, our ratio equaled 3.77 to 1; and

- an interest coverage ratio: for the twelve-month period ended September 30, 2008, Adjusted EBITDA to cash interest expense (interest expense, net excluding deferred debt issuance cost amortization and the movements in the mark-to market value of our interest rate and cross-currency interest rate derivatives) must be at least 1.95 to 1; for such period, our ratio equaled 4.63 to 1.

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Effective October 1, 2008, our leverage ratio must be 4.50 to 1 and effective January 1, 2009, our leverage ratio must be 4.25 to 1 under the terms of our credit agreement. These covenants are material terms of the senior secured credit agreement. Non-compliance with these covenants or other covenants could result in a default under the senior secured credit agreement and the lenders could elect to declare all amounts borrowed immediately due and payable. Any such acceleration would also result in a default under the indenture governing the 2014 Notes, which could lead to the note holders electing to declare the principal, premium, if any, and interest on the then outstanding notes immediately due and payable. The senior secured credit agreement contains a cross default provision for indebtedness in excess of \$30.0 million; therefore, a default under the indenture governing the 2014 Notes or other indebtedness may cause the lenders to declare the principal and interest on the then outstanding senior secured credit facilities immediately due and payable.

See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Definitions of Adjusted EBITDA, for a discussion of the definition of Adjusted EBITDA used in calculating our financial covenants.

We were in compliance with the above covenants as of September 30, 2008 and December 31, 2007.

*2014 Notes.* The 2014 Notes have an aggregate principal amount of 375.0 million (\$528.5 million) in the case of the Euro notes and \$200.0 million in the case of the U.S. Dollar notes, and mature on November 15, 2014. Interest on the 2014 Notes is payable semi-annually on May 15 and November 15. Interest on the 2014 Notes accrues at the rate of 7.625% in the case of the Euro notes and 7.500% in the case of the U.S. Dollar notes. Certain of our domestic subsidiaries guarantee the 2014 Notes on a senior subordinated unsecured basis.

The 2014 Notes contain various affirmative and restrictive covenants. The restrictive covenants limit our ability, and the ability of our restricted subsidiaries, to, among other things, incur or guarantee additional indebtedness (as described below under Covenant Compliance), pay dividends or make other equity distributions or repurchase capital stock, make investments or other restricted payments, create liens, transfer or sell assets, restrict dividends or other payments to us, engage in transactions with affiliates, and merge or consolidate with other companies or sell substantially all of our assets.

The indenture governing the 2014 Notes prohibits us from incurring additional debt, subject to certain permitted incurrences, unless the fixed charge coverage ratio, which is the ratio of Adjusted EBITDA (as defined therein excluding certain adjustments permitted under the senior secured credit agreement) to fixed charges (as defined therein), for the most recently ended four fiscal quarters is at least 2.00 to 1. In addition, the indenture prohibits us from making restricted payments (such as dividends or other equity distributions,



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repurchases of capital stock or restricted investments), subject to certain permitted payments, unless, among other things, the fixed charge coverage ratio for the most recently ended four fiscal quarters is at least 2.00 to 1. For the four-fiscal quarter period ended September 30, 2008, the fixed charge coverage ratio equaled 4.63 to 1. This covenant is a material term of the indenture governing the 2014 Notes.

Because the indenture governing the 2014 Notes defines an event of default to include, among other things, a default under any other debt obligation in excess of \$35.0 million that could cause the acceleration of such obligation, any acceleration under the senior secured credit agreement or other debt agreement would also result in a default under the indenture governing these notes, which could lead to the note holders electing to declare the principal, premium, if any, and interest on the then outstanding notes immediately due and payable.

*Titanium Dioxide Pigments venture term loans and revolving credit facility.* The Titanium Dioxide Pigments venture entered into a facility agreement that provides for a term loan facility in an aggregate amount of 250.0 million and a revolving credit facility in an aggregate amount of 30.0 million (\$42.3 million), both maturing on June 17, 2013. On September 3, 2008, the Titanium Dioxide Pigments venture borrowed 250.0 million (\$352.3 million) under the term loan facility. As of September 30, 2008, there were no outstanding borrowings under this revolving credit facility.

The loans are secured by the assets of the venture. In the event that either Kemira's or Rockwood's ownership interest changes, any lender may cancel its commitment and demand repayment of its respective portion of the loans, including accrued and unpaid interest. The facility agreement contains customary events of default, subject to remedy periods, thresholds and exceptions. Upon the occurrence of an event of default under the facility agreement, the lenders can terminate the commitments and declare all amounts, including accrued and unpaid interest, to be due and payable.

The interest rate on the loans is EURIBOR (or LIBOR if the currency is not EURO) plus 3%, subject to a step down determined by reference to a leverage ratio test. The term loan shall be repaid in installments over a five-year period from the date of the facility agreement, with payments commencing twelve months from such date; both loans may be repaid in advance without penalty.

The facility agreement contains affirmative and restrictive covenants, subject to certain thresholds and exceptions. The restrictive covenants limit the venture's ability to undertake certain actions, including but not limited to acquiring or disposing of assets, creating liens on assets, entering into a merger or corporate restructuring, and incurring additional indebtedness. In addition, the facility agreement requires the venture to meet certain financial covenants, including:

- A leverage coverage ratio: for the twelve-month period ended September 30, 2008, net debt to EBITDA, subject to certain adjustments (which is substantially similar to the definition of Adjusted EBITDA in our senior secured credit agreement) must be less than 4.00 to 1: for such period, our ratio equaled 3.52 to 1;
- An interest coverage ratio: EBITDA, subject to certain adjustments to cash interest expense, must be greater than 2.75 to 1; the first period for compliance for this ratio is December 31, 2008; and

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- Cash flow coverage ratio: cash generated for financing activities to debt service must be greater than 1.00; the first period for compliance for this ratio is December 31, 2008.

We were in compliance with the above covenant as of September 30, 2008.

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Given our use of Adjusted EBITDA (see Special Note Regarding Non-GAAP Financial Measures for the definition of Adjusted EBITDA and management's uses of Adjusted EBITDA) as a liquidity measure, the following table presents a reconciliation of net cash provided by operating activities to Adjusted EBITDA:

(\$ in millions)	Nine months ended September 30,	
	2008	2007
Net cash provided by operating activities from continuing operations	\$ 239.5	\$ 255.9
Changes in assets and liabilities, net of the effect of foreign currency translation and acquisitions	94.2	24.8
Current portion of income tax provision	36.4	32.5
Interest expense, net, excluding amortization of deferred financing costs and unrealized losses/gains on derivatives	121.6	126.2
Restructuring and related charges	5.7	8.9
Systems/organization establishment expenses	7.1	1.8
Cancelled acquisition and disposal costs	0.9	2.8
Refinancing expenses		0.9
Inventory write-up charges	4.2	2.8
Bad debt provision	(0.9)	(1.2)
Gain on sale of assets	(1.8)	(5.3)
Other	0.6	(0.8)
<b>Total Adjusted EBITDA</b>	<b>\$ 507.5</b>	<b>\$ 449.3</b>

### ***Contractual Obligations***

The Company is obligated to make future payments under various contracts such as debt agreements (including scheduled cash interest payments), operating lease agreements, and unconditional purchase obligations. A discussion of these contractual obligations is included in the Company's 2007 Form 10-K. Liabilities for unrecognized tax benefits in the amount of \$26.7 million as of December 31, 2007 related to Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109*, were excluded from the Contractual Obligations table as we were unable to make a reasonably reliable estimate of the period of cash settlement with the respective taxing authorities. Liabilities for these unrecognized tax benefits are classified as non-current income tax liabilities (other liabilities) unless expected to be paid in one year. There have not been significant changes to these contractual obligations as of September 30, 2008, except for the additional borrowings related to the formation of the Titanium Dioxide Pigments venture in September 2008.

### ***Capital Expenditures***

Rockwood's capital expenditures for the nine months ended September 30, 2008 consisted primarily of replacements of worn, obsolete or damaged equipment as well as investments in new equipment.

For the nine months ended September 30, 2008 and 2007, our capital expenditures, excluding capital leases, were \$157.1 million and \$135.5 million, respectively. Capital expenditures for each of our reporting segments are provided in the following table:

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(\$ in millions)	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Specialty Compounds	Corporate and other	Consolidated
Nine months ended September 30, 2008	\$ 50.8	\$ 30.3	\$ 31.0	\$ 32.0	\$ 8.7	\$ 4.3	\$ 157.1
Nine months ended September 30, 2007	42.7	23.5	28.9	21.5	14.6	4.3	135.5

We may incur future costs for capital improvements and general compliance under Safety, Health and Environmental ( SHE ) laws. For the year ended December 31, 2007, our capital expenditures for SHE matters totaled \$29.6 million, excluding costs to maintain and repair pollution control equipment. For 2008, we estimate capital expenditures for compliance with SHE laws to be at similar levels; however, because capital expenditures for these matters are subject to changes in and new SHE laws, we cannot provide assurance that our recent expenditures will be indicative of future amounts required to comply with these laws, including the EU's Registration, Evaluation and Authorization of Chemicals ( REACH ) legislation. See Note 15, Commitments and Contingencies, Regulatory Developments for a discussion of REACH.

*Foreign currency related transactions*

As of September 30, 2008, \$1,516.6 million of the debt outstanding is denominated in euros.

**Recent Accounting Pronouncements**

See Note 1, Description of Business and Summary of Significant Accounting Policies, for a discussion of recent accounting pronouncements.

**Off-Balance Sheet Arrangements**

In the normal course of business, the Company incurs obligations which include guarantees related to contract completion, regulatory compliance and product performance. Under certain circumstances, these obligations are supported through the issuance of letters of credit and other bank guarantees. As of September 30, 2008, the Company had approximately \$29.2 million of letters of credit and other bank guarantees, of which \$24.8 million will expire in 2008 through 2012. The remaining guarantees have no specified expiration date. This amount includes outstanding letters of credit of \$24.6 million that reduced our availability under the senior secured credit facility. In the opinion of management, such obligations will not significantly affect the Company's financial position, results of operations or cash flows as the Company anticipates fulfilling its performance obligations.

**Commitments and Contingencies**

See Note 15, Commitments and Contingencies, for a discussion of the Company's Commitments and Contingencies.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. These estimates include assessing, among other things:

- the fair values of assets acquired and liabilities assumed in business combinations;
- the use and recoverability of inventory;

- the valuation of deferred tax assets;
- the amount of unrecognized tax benefits in accordance with FIN 48;
- impairment of goodwill, property, plant and equipment and other intangible assets; and
- the useful lives of tangible and intangible assets.

We evaluate our estimates on an ongoing basis, based on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The significant accounting policies of the Company are described in Note 1, Description of Business and Summary of Significant Accounting Policies, to the unaudited condensed consolidated financial statements and the critical accounting policies and estimates are described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section in the Company's 2007 Form 10-K. There have been no significant changes to these critical accounting policies and estimates as of September 30, 2008.

One of our critical accounting policies relates to the impairment of goodwill, property, plant and equipment and other intangible assets. The recoverability of goodwill is reviewed on an annual basis during the fourth quarter. Additionally, the recoverability of goodwill, property, plant and equipment and other intangible assets is reviewed when events or changes in circumstances occur indicating that the carrying value of the assets may not be recoverable.

Due to the recent economic downturn, some of our businesses have been negatively impacted. In particular, the downturn in the domestic housing market has had an unfavorable impact our Color Pigments and Services and Timber Treatment Chemicals businesses that are part of our Performance Additives segment. In our Titanium Dioxide Pigments segment, market conditions, including pricing pressure and current industry overcapacity, have negatively impacted this segment. As of September 30, 2008, our analysis indicates that the fair values of our reporting units exceeded their carrying amounts and therefore, we did not have a triggering event requiring an interim impairment review.

We will continue to monitor the economic environment and any impact it may have on our businesses and will perform our annual

goodwill impairment review in the fourth quarter of 2008.

### **Forward-Looking Statements**

This document contains forward-looking statements. Forward-looking statements are not statements of historical fact and may involve a number of risks and uncertainties. Forward-looking statements give our current expectations or forecasts of future events and estimates of amounts not yet determinable. We have used the words anticipate, estimate, expect, project, intend, plan, believe, predict, could, may and terms of similar meaning, including references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those expressed in or implied by these forward-looking statements. In particular, these factors include, among other things:

- our business strategy;
- competitive pricing or product development activities affecting demand for our products;
- fluctuations in interest rates, exchange rates and currency values;
- availability and pricing of raw materials;
- fluctuations in energy prices;
- changes in the end-use markets in which our products are sold;
- changes in the general economic conditions in North America and Europe and in other locations in which we currently do business;
- our ability to access capital markets;
- technological changes affecting production of our materials;
- governmental and environmental regulations and changes in those regulations;
- hazards associated with chemicals manufacturing;
- our high level of indebtedness;
- risks associated with negotiating, consummating and integrating acquisitions;
- risks associated with competition and the introduction of new competing products, especially in the Asia-Pacific region; and
- risks associated with international sales and operations.

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You should keep in mind that any forward-looking statements made by us in this document or elsewhere speak only as of the date on which we make them. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We are exposed to market risk from changes in interest rates, foreign currency exchange rates and commodity prices. We manage our exposure to these market risks through regular operating and financing activities and through the use of derivatives. When used, derivatives are employed as risk management tools and not for trading purposes. A discussion and analysis of the Company's market risk is included in the Company's 2007 Form 10-K. There have been no significant changes to these market risks as of September 30, 2008.

### **Item 4. Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2008 and concluded that our disclosure controls and procedures are effective. In connection with this evaluation, our management did not identify any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting during the third quarter of 2008.



## PART II OTHER INFORMATION

### Item 1. Legal Proceedings.

We are involved in legal proceedings from time to time in the ordinary course of our business, including with respect to product liability, intellectual property and environmental matters. In addition, we may be required to make indemnity payments in connection with certain product liability and environmental claims. See Item 1, Business, and Item 1A, Risk Factors, Environmental Indemnities We may be subject to environmental indemnity claims relating to properties we have divested ; Product Liability Due to the nature of our business and products, we may be liable for damages arising out of product liability claims ; and Product Liability Due to the nature of our business and products, we may be liable for damages arising out of certain indemnity claims in our 2007 Form 10-K. However, we do not believe that there is any other individual, governmental, legal proceeding or arbitration that is likely to have a material adverse effect on our business, results of operations, cash flows or financial condition. We cannot predict the outcome of any litigation or the potential for future litigation. See Note 15, Commitments and Contingencies, and Item 3, Legal Proceedings in our 2007 Form 10-K for descriptions of other legal matters.

### Item 1A. Risk Factors.

A discussion of the Company's risk factors is included in the Company's Form 10-K for the year ended December 31, 2007. There have been no material changes to these risk factors, except for the following:

#### **Downturns in certain industries and general economic conditions could adversely affect our profitability.**

In the event that the volatile conditions affecting worldwide financial markets persist or result in a prolonged economic downturn or recession, our results of operations, cash flows and financial position could be materially and adversely affected. Under such circumstances, the demand for our products could decrease, which would adversely affect our results of operations. In addition, our products are used in certain industries, such as the automotive, data and communications and construction industries. Prolonged downturns in one or more of these industries could severely reduce demand for our products. For example, sales in our Performance Additives business have been adversely impacted by downward trends in commercial and residential construction, housing starts and trends in residential repair and remodeling. Further, a downturn in the automotive industry, particularly in Europe, may adversely affect the results of operations of our Surface Treatment business in our Specialty Chemicals segment. Moreover, if the value of one or more of our businesses deteriorates, we may be required to record impairment charges that could adversely affect our results of operations. If we are unable to successfully anticipate or respond to changing economic conditions, our results of operations and financial position may be materially and adversely affected.

Further, a prolonged economic downturn or recession or further market disruption in the capital and credit markets may adversely impact our future cash flows from operations and our liquidity. For example, the recent deterioration of these markets has had a material and adverse impact on our pension plan assets, which may require us to make certain payments into these plans in the form of a one-time payment or over an extended period, and any further deterioration in the capital markets may require us to fund additional amounts in the future. Any such payments may materially and adversely impact our liquidity. If our sources of liquidity are insufficient to meet our needs, we may be forced to use other means available to us, such as reduce or delay capital expenditures or other cost cutting measures or seek additional sources of capital such as through additional borrowings, equity issuances or other sources, to satisfy our liquidity needs. The recent unprecedented adverse conditions in the global capital and credit markets may limit our ability to secure capital or obtain it on terms and conditions that are acceptable to us. We cannot predict with any certainty the impact of this or any further disruption in these markets or our ability to access these markets in the future.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

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- 32.1 Section 1350 Certification of Chief Executive Officer. This certification accompanies this report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 or any other provision of the Securities Exchange Act of 1934, as amended.
- 32.2 Section 1350 Certification of Chief Financial Officer. This certification accompanies this report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 or any other provision of the Securities Exchange Act of 1934, as amended.

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\* Filed herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ROCKWOOD HOLDINGS, INC.

By: /s/ SEIFI GHASEMI  
Seifi Ghasemi  
Chairman of the Board and Chief Executive Officer  
Date: November 7, 2008

ROCKWOOD HOLDINGS, INC.

By: /s/ ROBERT J. ZATTA  
Robert J. Zatta  
Senior Vice President and Chief Financial Officer  
Date: November 7, 2008