Rockwood Holdings, Inc.
Form 10-Q
November 14, 2006

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, 2006

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	**52-2277366**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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. x Yes o No

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x 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 10, 2006, there were 73,784,632 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, 2006	2005	Nine months ended September 30, 2006	2005
NET SALES	$ 827.0	$ 771.7	$ 2,495.4	$ 2,358.8
COST OF PRODUCTS SOLD	579.7	538.2	1,729.5	1,636.7
GROSS PROFIT	247.3	233.5	765.9	722.1
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	159.5	143.8	478.8	451.5
RESTRUCTURING CHARGES, net	1.7	2.9	3.9	8.7
MANAGEMENT SERVICES AGREEMENT TERMINATION FEE		10.0		10.0
OPERATING INCOME	86.1	76.8	283.2	251.9
OTHER INCOME (EXPENSES):				
Interest expense, net	(60.8)	(55.4)	(147.7)	(177.6)
Loss on early extinguishment of debt		(26.6)		(26.6)
Foreign exchange gain, net	4.8	2.1	7.7	116.1
Loss on sale of business			(12.1)	
Other, net	0.3		2.7	
Net	(55.7)	(79.9)	(149.4)	(88.1)
INCOME (LOSS) BEFORE TAXES AND MINORITY INTEREST	30.4	(3.1)	133.8	163.8
INCOME TAX PROVISION	12.4	10.8	34.5	52.5
NET INCOME (LOSS) BEFORE MINORITY INTEREST	18.0	(13.9)	99.3	111.3
MINORITY INTEREST	3.4	0.6	(0.8)	2.3
NET INCOME (LOSS)	$ 21.4	$ (13.3)	$ 98.5	$ 113.6
Per share data:				
BASIC EARNINGS (LOSS) PER COMMON SHARE	$ 0.29	$ (0.25)	$ 1.34	$ 2.02
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$ 0.29	$ (0.25)	$ 1.31	$ 1.98
WEIGHTED AVERAGE NUMBER OF BASIC SHARES OUTSTANDING	73,782	61,845	73,781	54,197
WEIGHTED AVERAGE NUMBER OF DILUTED SHARES OUTSTANDING	74,915	61,845	75,001	55,092

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, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 70.0	$ 102.2
Accounts receivable, net	522.2	484.2
Inventories	494.0	458.2
Deferred income taxes	8.4	12.2
Prepaid expenses and other current assets	48.3	68.1
Total current assets	1,142.9	1,124.9
PROPERTY, PLANT AND EQUIPMENT, net	1,502.7	1,402.4
GOODWILL	1,681.9	1,599.2
OTHER INTANGIBLE ASSETS, net	586.1	583.0
DEFERRED DEBT ISSUANCE COSTS, net of accumulated amortization of $22.2 and $13.5, respectively	52.5	56.6
OTHER ASSETS	59.5	44.0
TOTAL ASSETS	$ 5,025.6	$ 4,810.1
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 268.8	$ 295.7
Income taxes payable	25.6	18.9
Accrued compensation	103.3	92.0
Restructuring liability	8.6	13.6
Accrued expenses and other current liabilities	232.3	191.1
Senior secured revolving credit facility		30.0
Long-term debt, current portion	98.2	83.1
Total current liabilities	736.8	724.4
LONG-TERM DEBT	2,716.7	2,730.7
PENSION AND RELATED LIABILITIES	374.1	361.6
DEFERRED INCOME TAXES	34.7	27.2
OTHER LIABILITIES	98.7	106.3
Total liabilities	3,961.0	3,950.2
MINORITY INTEREST	28.0	25.2
STOCKHOLDERS EQUITY:		
Common stock ($0.01 par value, 400,000 shares authorized, 73,879 shares issued and 73,785 shares outstanding at September 30, 2006; 400,000 shares authorized, 73,873 shares issued and 73,779 shares outstanding at December 31, 2005)	0.7	0.7
Paid-in capital	1,151.8	1,151.7
Accumulated other comprehensive income	154.6	52.0
Accumulated deficit	(269.1)	(367.6)
Treasury stock, at cost	(1.4)	(1.4)
Other		(0.7)
Total stockholders equity	1,036.6	834.7
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 5,025.6	$ 4,810.1

See accompanying notes to condensed consolidated financial statements.

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ROCKWOOD HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

(Unaudited)

	Nine months ended September 30, 2006	**2005 As restated See Note 16**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 98.5	$ 113.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	165.2	154.7
Deferred financing costs amortization	7.2	8.3
Loss on early extinguishment of debt (including $13.4 million of non- cash write-offs on deferred financing costs)		26.6
Foreign exchange gain, net	(7.7)	(116.1)
Non-cash interest expense on pay-in-kind loans		24.1
Loss on sale of business, net of cash	11.3	
Gains related to asset sales	(0.7)	
Fair value adjustment of derivatives	(6.4)	(12.6)
Bad debt provision	0.6	0.8
Deferred income taxes	10.3	18.5
Minority interest	0.8	(2.3)
Changes in assets and liabilities, net of the effect of foreign currency translation and acquisitions:		
Accounts receivable	(20.1)	(15.0)
Inventories, including inventory write-up reversal	(28.1)	(23.1)
Prepaid expenses and other assets	18.7	(4.9)
Accounts payable	(27.0)	35.2
Income taxes payable	17.3	10.7
Accrued expenses and other liabilities	6.8	(19.6)
Net cash provided by operating activities	246.7	198.9
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired	(13.4)	
Post closing purchase price consideration		(16.1)
Capital expenditures, excluding capital leases	(146.4)	(139.3)
Proceeds on sale of property, plant and equipment	4.0	0.2
Net cash used in investing activities	(155.8)	(155.2)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock, net of fees		435.7
Proceeds from senior secured credit facilities	170.2	331.0
Repayment of senior secured credit facilities	(242.7)	(338.4)
Long-term debt repayments from IPO proceeds		(370.7)
Payments on other long-term debt	(48.2)	(26.2)
Redemption of redeemable convertible preferred stock from IPO proceeds		(38.5)
Costs related to early extinguishment of debt		(13.2)
Net cash used in financing activities	(120.7)	(20.3)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(2.4)	(0.9)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(32.2)	22.5
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	102.2	111.3
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 70.0	$ 133.8
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid, net	$ 116.9	$ 128.6
Income taxes paid, net of refunds	$ 11.2	$ 24.9
NON-CASH INVESTING ACTIVITIES:		

Acquisition of equipment under capital leases	$	4.1	$	4.9
Decrease in liabilities for property, plant and equipment	$	(16.4)	$	(16.3)

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 (Rockwood or the Company) is a global developer, manufacturer and marketer of high value-added specialty chemicals and advanced materials used for industrial and commercial purposes. Rockwood is the ultimate parent company of Rockwood Specialties Group, Inc. (Group).

Rockwood is controlled by affiliates of Kohlberg Kravis Roberts & Co. L.P. (KKR) and was formed in connection with an acquisition of certain assets, stock and businesses from Laporte plc (Laporte) on November 20, 2000 (the KKR Acquisition).

On July 31, 2004, the Company completed the acquisition of four businesses of Dynamit Nobel from mg technologies ag and MG North America Holdings, Inc. (the Dynamit Nobel Acquisition). The businesses acquired are focused on highly specialized markets and consist of: white pigments, surface treatment and lithium chemicals, ceramics and pharmaceutical intermediates.

On August 22, 2005, the Company completed an initial public offering (IPO) of 23,469,387 shares of its common stock, which included 3,061,224 shares issued and sold as a result of the underwriters exercise of the over-allotment option.

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-year balances have been reclassified to conform to current year presentation.

The interim financial statements included herein are unaudited. 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 2005 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 results of operations for the interim periods are not necessarily indicative of the results of operations for the full year.

The Company s minority interest represents the total of the minority party s interest in certain investments (principally the Groupe Novasep segment) that are consolidated but less than 100% owned.

Effective July 18, 2005, the Company s Board of Directors authorized a 34.22553019-for-one stock split of its common stock and increased the company s authorized shares of common stock to 400 million shares. As a result of the stock split, the accompanying condensed consolidated financial statements reflect an increase in the number of outstanding shares of common stock and the transfer of the additional paid-in-capital to par value. All share amounts have been restated to reflect the retroactive effect of the stock split for all periods presented.

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 operates in various business lines within its seven 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, clay-based additives, and water treatment chemicals, (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, (5) Groupe Novasep, which includes sensitive chemistry, highly potent active ingredients and chiral technologies for the synthesis of pharmaceutical compounds and purification and separation process equipment, systems and studies, (6) Specialty Compounds, which consists of plastic compounds, and (7) Electronics, which consists of electronic chemicals, wafer reclaim and photomasks.

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 4, 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

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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, impairment of goodwill as well as property, plant and equipment and other intangible assets, 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 DLJ Merchant Banking Partners III, L.P. (DLJMB) and affiliates of each. Prior to the IPO, KKR and DLJMB had provided the Company with consulting and management advisory services for an annual fee of $2.1 million, increasing 5% annually. In connection with the IPO, the parties agreed to terminate the management services agreement for an aggregate consideration of $10.0 million.

Revenue Recognition The Company recognizes revenue when the earnings process is complete, except for amounts (less than 1% of consolidated revenues in 2005) derived from long-term contracts accounted for under the percentage of completion method within the Groupe Novasep segment. 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 is realized when the service is performed.

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) are included in determining net income for the period in which exchange rates change. However, the related gains or losses on certain intercompany transactions 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 our euro-denominated investments are reported and accumulated in the same manner as translation adjustments.

Accretion on Senior Discount Notes The Company s senior discount notes accreted principal value for a portion of their term. The Company recorded such accretion as interest expense for financial reporting purposes. As a result of the completion of the IPO, the Company used $89.2 million of the proceeds to redeem the outstanding principal amount of the senior discount notes (including accreted and unpaid interest).

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*. Other postretirement benefit costs and liabilities have been determined in accordance with SFAS 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*. Postemployment benefit costs and liabilities have been determined in accordance with SFAS 112, *Employers Accounting for Postemployment Benefits*. See Note 11, Employee Benefit Plans, for further detail.

Income Taxes Income taxes are determined in accordance with SFAS 109, *Accounting for Income Taxes*. 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

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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.

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 as well as minimum pension liability adjustments that are recorded directly into a separate section of stockholders equity in the balance sheets. Also included are the net investment hedges discussed below. 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 is summarized as follows:

($ in millions)	**Three months ended September 30, 2006**	**2005**	**Nine months ended September 30, 2006**	**2005**
Net income (loss)	$ 21.4	$ (13.3)	$ 98.5	$ 113.6
Foreign currency translation	(4.8)	(5.4)	79.3	(125.0)
Intercompany foreign currency transactions	(12.0)	(5.3)	89.4	(167.1)
Net investment hedge, net of tax	12.5	(10.3)	(70.7)	20.9
Reduction of minimum pension liability, net of tax			4.6	
Total comprehensive income (loss)	$ 17.1	$ (34.3)	$ 201.1	$ (157.6)

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, 2006 and December 31, 2005. The Company does not expect any of the loss on the net investment hedge residing in comprehensive income at September 30, 2006 to be reclassified into earnings during the subsequent twelve months.

In addition, we designated the remaining portion of our euro-denominated debt that is recorded on our U.S. books as a net investment hedge of our euro-denominated investments as of October 1, 2005 (euro-denominated debt of 684.3 million or $867.3 million based on the September 30, 2006 exchange rate of 1.00 = $1.2674). As a result, effective October 1, 2005, any foreign currency gains and losses resulting from the euro-denominated debt discussed above is accounted for as a component of accumulated other comprehensive income. There was no ineffective portion of the net investment hedge as of September 30, 2006. The Company does not expect any of the loss on the net investment hedge residing in comprehensive income at September 30, 2006 to be reclassified into earnings during the subsequent twelve months.

Accounting for Environmental Liabilities In the ordinary course of business, the Company 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. The Company 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, the Company may share costs with other parties. The Company does not include anticipated recoveries from insurance carriers or other third parties in its accruals for environmental liabilities. The Company s liability estimates are based upon available facts, existing technology, past experience and, in some instances, insurance recoveries where the remediation costs are being paid directly by the Company s insurers, and are generated by several means, including State-mandated schedules, environmental consultants and internal experts, depending on the circumstances.

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.

Recent Accounting Pronouncements The Company implemented the financial accounting standards listed below on January 1, 2006. The adoption of these standards did not have a material impact on the Company.

SFAS 123R	Share-Based Payment
SFAS 151	Inventory Costs
SFAS 153	Exchanges of Nonmonetary Assets
SFAS 154	Accounting Changes and Error Corrections

SFAS 123R revises SFAS 123, *Accounting for Stock-Based Compensation,* and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. SFAS 123R requires entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. These costs are recognized over the period during which the employee is required to provide services in exchange for the award. This standard eliminates the use of the intrinsic value method of accounting for share-based payments as previously provided in APB 25. The Company is applying SFAS 123R on a modified prospective basis. In accordance with SFAS 123R, beginning in the first quarter of 2006, the Company recorded compensation cost for the unvested portion of awards issued after February 2005, which is the date it first filed its registration statement with the Securities and Exchange Commission (SEC), and for any awards modified, repurchased or cancelled after this date. See Note 2, Share-Based Payment (SFAS No. 123R), and Note 3, Stock-Based Compensation, for further details of the impact of adopting this standard.

SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), requiring that such items be recognized as current-period charges. This statement eliminates a narrow difference between the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) accounting standards to improve the comparability of cross-border financial reporting.

SFAS 153 eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. This statement eliminates a narrow difference between the FASB and IASB accounting standards to improve the comparability of cross-border financial reporting.

SFAS 154 replaces APB Opinion No. 20, *Accounting Changes*, and SFAS Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that (1) a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle and (2) correction of errors in previously issued financial statements should be termed a restatement. This statement eliminates a narrow difference between the FASB and IASB accounting standards to improve the comparability of cross-border financial reporting.

The Company will adopt the following in the future as they are required:

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, which provides interpretive guidance on how registrants should quantify financial statement misstatements. Prior to SAB 108, there were two methods most commonly used to quantify misstatements: the rollover method, which focused primarily on the income statement impact of misstatements, and the iron curtain method, which focused primarily on the balance sheet impact of misstatements. Under SAB 108, registrants will be required to consider both the rollover and iron curtain methods (i.e., dual approach) when evaluating the materiality of financial statement errors. SAB 108 is effective for the Company for its financial statements for the year ended December 31, 2006. The adoption of this SAB is not expected to have an impact on the Company s financial statements for the year ended December 31, 2006.

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. This statement is effective for the Company as of January 1, 2008. The Company is currently evaluating the impact this statement will have on its 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. This statement requires an employer to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. In addition, employers are required to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. SFAS No. 158 also has expanded the disclosure requirements for pension plans and other postretirement plans. This statement provides different effective dates for the recognition and related disclosure provisions and for the required change to a fiscal year-end measurement date. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective for the Company as of the end of the year ending December 31, 2006. 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 fiscal year ended December 31, 2008. The Company is currently evaluating the impact this statement will have on its financial statements.

The Company will adopt the following in the first quarter of 2007:

In June 2006, a final consensus was reached on Emerging Issues Task Force (EITF) Issue No. 06-3, *How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation).* The scope of this Issue includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. This Issue affirms that the presentation of taxes in the income statement should be on either a gross (included in revenues and costs) or a net (excluded from revenues) basis and that this is an accounting policy decision that should be disclosed pursuant to APB Opinion No. 22. In addition, if such taxes are significant and reported on a gross basis, the amounts of those taxes should be disclosed in interim and annual financial statements. The Company will adopt this EITF in the first quarter of 2007. The Company currently records taxes collected from customers and remitted to governmental authorities on a net basis.

In July 2006, FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*, was issued. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company will adopt this interpretation in the first quarter of 2007 and is currently evaluating the impact it will have on its financial statements.

In September 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1, *Accounting for Planned Major Maintenance Activities*. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. It continues to permit the application of three alternative methods of accounting for planned maintenance activities: direct expense, built-in-overhaul and deferral methods. In addition, this FSP requires disclosure of the method of accounting for planned maintenance activities selected. The Company will adopt this FSP in the first quarter of 2007 and does not expect its adoption to have a material impact on its financial statements.

2. SHARE-BASED PAYMENT (SFAS NO. 123R):

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. Prior to January 1, 2006, the Company applied the recognition and measurement principles of APB Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, no compensation expense was recognized in net income for employee stock options, as the options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The estimated impact of adopting SFAS No. 123R in 2006 is expected to reduce net income for the year by approximately $0.2 million before taxes (and to reduce diluted earnings per share for the year by less than $0.01 per share).

As noted above under Recent Accounting Pronouncements, the Company adopted SFAS No. 123R using the modified prospective approach and therefore has not restated prior periods. As a result, the Company is recording compensation cost for the unvested portion of awards issued after February 2005 and for any awards modified, repurchased or cancelled after this date. In the three and nine months ended September 30, 2006, the adoption of SFAS No. 123R resulted in incremental stock-based compensation expense of $0.1 million and $0.2 million, respectively. The incremental stock-based compensation expense caused income before taxes and minority interest to decrease by $0.1 million, net income to decrease by less than $0.1 million and basic and diluted earnings per share to decrease by less than $0.01 per share for the three months ended September 30, 2006. For the nine months ended September 30, 2006, the incremental stock-based compensation expense caused income before taxes and minority interest to decrease by $0.2 million, net income to decrease by $0.1 million and basic and diluted earnings per share to decrease by less than $0.01 per share.

SFAS No. 123R modified the disclosure requirements related to share-based compensation. Accordingly, the disclosures prescribed by SFAS No. 123R are included in Note 3, Stock-Based Compensation.

For stock options granted prior to the adoption of SFAS No. 123R, the Company applied APB Opinion 25 to account for its stock-based awards. If compensation cost for the Company s stock option plans had been determined based on the fair value at grant date consistent with the provisions of SFAS No. 123 as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*, the Company s net earnings and earnings per share would have been as follows:

($ in millions, except per share amounts)	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net (loss) income, as reported	$ (13.3)	$ 113.6
Less: Stock-based employee compensation expense determined under fair value based method, net of tax	(0.2)	(0.6)
Pro forma net (loss) income	(13.5)	113.0
Redeemable convertible preferred stock dividends	(2.0)	(4.3)
Pro forma net (loss) income applicable to common shareholders	$ (15.5)	$ 108.7
(Loss) earnings per common share, as reported:		
Basic	$ (0.25)	$ 2.02
Diluted	$ (0.25)	$ 1.98
Pro forma (loss) earnings per common share:		
Basic	$ (0.25)	$ 2.01
Diluted	$ (0.25)	$ 1.97

3. STOCK-BASED COMPENSATION:

Rockwood Plan

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.

Restricted Stock Restricted stock of the Company can be granted with or without payment of consideration with restrictions on the recipient s right to transfer or sell the stock. During the third quarter of 2006, the Company granted 1,207 shares of restricted stock which vest over five years. The compensation cost related to this restricted stock caused income before taxes and minority interest to decrease by less than $0.1 million and net income to decrease by less than $0.1 million for the three and nine months ended September 30, 2006. The weighted average grant date fair value of the restricted shares granted in the third quarter of 2006 was $20.70. As of September 30, 2006, there was less than $0.1 million of unrecognized compensation cost related to restricted stock awards determined in accordance with SFAS No. 123R, which is expected to be recognized over a weighted-average period of approximately 4.9 years.

Stock Purchase Eligible employees and directors can purchase shares of the Company s common stock at prices as determined by its board of directors. Under the Plan, the Company sold 4,106 shares during the three and nine months ended September 30, 2006 at the fair market value of the stock ($20.70 per share) based on the closing price of the stock on the New York Stock Exchange on the date of purchase for gross proceeds of approximately $0.1 million.

Board of Directors Stock Options Stock options granted to directors under this Plan shall have an exercise price at least equal to the fair market value of the Company s common stock on the date of grant. Options available for grant under this Plan are time options which have a life of ten years from the date of grant and vest in three equal annual installments on each of the first three anniversaries of the grant date.

Stock Options Stock options granted under the Plan shall have an exercise price at least equal to the fair market value of the Company s common stock on the date of grant. There are two types of options available for grant under the Plan. Time options have a life of ten years from the date of grant and vest as follows: time options granted prior to 2004 vest 10% in year one, 10% year two, 25% year three, 25% year four and 30% year five; time options granted in 2004 and after vest in installments of 20% on each of the first five anniversaries of the grant date. Performance options have a life of ten years and become exercisable with respect to 20% of the total performance options granted upon the achievement of certain performance targets. Performance options become exercisable on the eighth anniversary of the grant date to the extent that the options have not become otherwise exercisable or have not been terminated. In October 2004, the performance targets were modified as a result of the Dynamit Nobel Acquisition. Certain option holders have company-wide performance targets, for which targets are based on the achievement by the Company of certain implied equity values. Other option holders have divisional performance targets, for which targets are based on a particular division s achievement of annual or cumulative Adjusted EBITDA.

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The Company recorded no compensation cost in the historical statements of operations related to the Plan prior to 2006. The measurement date for determining compensation expense for each option has been the option issuance date and at that time the market price of the stock was equal to the exercise price in each case. The time options have been accounted for as a fixed plan. The performance options have been treated similar to fixed stock option plans as the Company concluded the predefined (non-accelerated) vesting schedule is substantive as it is deemed to be more likely than not that the applicable individuals will remain employed with the Company through that vesting date, particularly if the performance trigger has not occurred. As such, the measurement date for these options is the option grant date in accordance with APB Opinion 25. The change to the applicable performance targets as a result of the Dynamit Nobel Acquisition was a permitted change per the applicable stock option agreements; as such no modification occurred requiring a new measurement date calculation.

The compensation cost charged against income under the Plan in accordance with SFAS No. 123R in the three and nine months ended September 30, 2006 for share-based compensation programs was less than $0.1 million and $0.1 million, respectively, before taxes.

The fair value of stock options granted in the three and nine months ended September 30, 2006 and 2005 are estimated on the date of grant using the Black-Scholes option pricing model that used the assumptions noted in the following table:

	Three months ended September 30,		**Nine months ended September 30,**	
	2006	**2005**	**2006**	**2005**
Expected term (in years)	7.2	6.9	6.8	6.9
Expected volatility	35%	35%	35%	35%
Risk-free rate	4.8%	4.2%	4.8%	4.2%
Expected dividends	N/A	N/A	N/A	N/A

The expected term represents the period of time that options granted are expected to be outstanding based on the simplified method for determining expected term of an employee share option (in accordance with SEC Staff Accounting Bulletin No. 107). As Rockwood became a public company in August 2005, there is not a long period of history of the Company s share price. As a result, the Company s expected volatility is based on the expected volatilities of comparable peer companies that are publicly traded. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividends are not applicable as the Company currently does not pay a dividend on its shares.

As of September 30, 2006, there was $0.4 million of unrecognized compensation cost related to nonvested stock options determined in accordance with SFAS No. 123R, which is expected to be recognized over a weighted-average period of approximately 4.0 years.

As of January 1, 2006 and September 30, 2006, the number of nonvested stock options determined in accordance with SFAS No. 123R was 53,800 and 47,814, respectively, and the weighted-average grant date fair value of nonvested stock options was $8.68 and $9.14, respectively.

The total intrinsic value of stock options exercised during the nine months ended September 30, 2006 was less than $0.1 million. Cash received from option exercises during the first nine months of 2006 was less than $0.1 million. The total tax benefit realized from options exercised in the first nine months of 2006 was less than $0.1 million. The total fair value of shares vested during the three and nine months ended September 30, 2006 was $0.2 million and $0.3 million respectively.

A summary of the status of the Company s options granted pursuant to the Plan at September 30, 2006 and changes during the period ended on that date is presented below:

	Shares (000)		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($ in millions)
Outstanding at December 31, 2005	3,863		$ 14.69		
Granted	27		21.87		
Exercised	(2	)	14.61		
Forfeited	(42	)	18.76		
Outstanding at September 30, 2006	3,846		$ 14.69	6.51	$ 20.3
Options exercisable at September 30, 2006	1,779		$ 14.62	5.91	$ 9.5
Weighted-average fair value of options granted during the period	$ 9.92				

Subsidiary Plan

Stock Options In September 2005, Groupe Novasep SAS (Groupe Novasep), a subsidiary of the Company, approved a stock option plan for certain of its employees (the Subsidiary Plan). Under the Subsidiary Plan, there are 24,543 authorized shares of Groupe Novasep stock available for grant. There are two types of options available for grant under the Subsidiary Plan. Time options have a life of 62 months from the date of grant and vest as follows: 20% per year at each one year anniversary. Performance options have a maximum life of ten years and become exercisable based on attainment of certain stock price targets on the occasion of certain triggering events (IPO or Change of Control).

Stock Purchase Eligible employees and management personnel of Groupe Novasep and its subsidiaries can purchase shares of common stock at prices as determined by the Supervisory Board of Groupe Novasep. Under the Subsidiary Plan, Groupe Novasep sold 4,013 shares during the quarter ended December 31, 2005 at the fair market value of the stock (211.00 per share) as determined by the Supervisory Board of Groupe Novasep at the date of purchase for gross proceeds of $1.0 million.

The Company recorded no compensation cost in the historical statements of operations related to the Subsidiary Plan prior to 2006. The time options qualified as a fixed plan in accordance with APB Opinion 25 prior to 2006. The performance options do not qualify as a fixed plan and therefore are accounted for as a variable plan. In accordance with FASB Interpretation No. 38, *Determining the Measurement Date for Stock Option, Purchase, and Award Plans Involving Junior Stock An Interpretation of APB Opinion No. 25*, as the triggering events were not probable, no compensation cost was recorded as of September 30, 2006 in accordance with SFAS No. 123R.

The compensation cost charged against income under the Subsidiary Plan for the time options in accordance with SFAS No. 123R in the three and nine months ended September 30, 2006 for share-based compensation programs was less than $0.1 million and $0.1 million, respectively, before taxes.

There were no options granted or exercised in the first nine months of 2006 under the Subsidiary Plan. The fair value of options granted in 2005 was estimated on the date of grant using the Black-Scholes option pricing model.

As of September 30, 2006, there was 0.9 million ($1.1 million using a September 30, 2006 exchange rate of 1.00 = $1.2674) of unrecognized compensation cost related to nonvested stock options under the Subsidiary Plan, which is expected to be recognized over a weighted-average period of approximately 3.0 years.

A summary of the status of the options granted by Groupe Novasep at September 30, 2006 and changes during the period ended on that date is presented below:

	Shares (000)		**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (years)**	**Aggregate Intrinsic Value (in millions)**
Outstanding at December 31, 2005	22		211.00		
Granted					
Exercised					
Forfeited	(2	)	211.00		
Outstanding at September 30, 2006	20		211.00	9.08	
Options exercisable at September 30, 2006					
Weighted-average fair value of options granted during the period					

4. SEGMENT INFORMATION:

Rockwood operates in seven 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 chief operating decision maker, who is the Company s Chief Executive Officer. The seven segments are: (1) Specialty Chemicals, which consists of the surface treatment and fine chemicals business lines; (2) Performance Additives, which consists of the color pigments and services, timber treatment chemicals, clay-based additives and water treatment chemicals business lines; (3) Titanium Dioxide Pigments; (4) Advanced Ceramics; (5) Groupe Novasep; (6) Specialty Compounds; and (7) Electronics, which consists of the electronic chemicals, wafer reclaim and photomasks business lines.

Items that cannot be readily attributed to individual segments have been classified as Corporate. Corporate operating loss primarily represents payroll, professional fees and other operating expenses of centralized functions such as treasury, legal, internal auditing and consolidation accounting as well as the cost of operating our central offices (including some maintained based on legal or tax considerations). The primary components of corporate 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 Corporate components within the reconciliation of income before taxes and minority interest (described more fully below) include systems/organization establishment expenses such as outside consulting costs for Sarbanes-Oxley initial documentation and fees relating to the implementation of a new consolidation software system, tax provision (benefit) resulting from corporate income (losses), interest expense on external debt, foreign exchange losses or gains, refinancing expenses related to external debt and initial public offering related expenses. Corporate 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 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. These operations are substantially unrelated by nature to businesses currently within the Company s operating segments.

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	Groupe Novasep	Specialty Compounds	Electronics	Corporate	Consolidated
Three months ended September 30, 2006									
Net sales	$ 225.5	$ 192.4	$ 111.2	$ 95.6	$ 87.2	$ 62.1	$ 53.0	$	$ 827.0
Adjusted EBITDA	49.0	31.3	23.2	25.8	13.9	8.2	9.6	(13.4)	147.6
Three months ended September 30, 2005									
Net sales	$ 202.6	$ 170.7	$ 106.6	$ 95.3	$ 92.0	$ 57.6	$ 46.9	$	$ 771.7
Adjusted EBITDA	40.8	36.9	21.5	24.5	12.3	6.6	7.7	(10.3)	140.0
Nine months ended September 30, 2006									
Net sales	$ 685.6	$ 587.7	$ 330.4	$ 286.3	$ 260.0	$ 191.4	$ 154.0	$	$ 2,495.4
Adjusted EBITDA	151.1	107.4	65.9	75.0	49.6	24.1	27.9	(38.5)	462.5
Nine months ended September 30, 2005									
Net sales	$ 642.3	$ 520.3	$ 320.3	$ 283.6	$ 279.9	$ 177.8	$ 134.6	$	$ 2,358.8
Adjusted EBITDA	133.2	118.3	64.5	70.0	35.3	21.3	20.5	(29.4)	433.7

	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Groupe Novasep	Specialty Compounds	Electronics	Corporate (a)	Eliminations (b)	Consolidated
Identifiable assets as of:										
September 30, 2006	$ 1,774.9	$ 1,028.4	$ 687.9	$ 717.9	$ 358.0	$ 234.0	$ 349.1	$ 267.6	$ (392.2)	$ 5,025.6
December 31, 2005	1,501.6	1,011.5	644.8	653.3	396.7	221.9	323.6	258.1	(201.4)	4,810.1

(a) This includes $63.1 million and $39.7 million of assets from the legacy businesses formerly belonging to Dynamit Nobel at September 30, 2006 and December 31, 2005, respectively.

(b) 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.

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 2005 Form 10-K.

The summary of segment information above includes Adjusted EBITDA, a financial measure used by the chief operating decision maker, who is the Company s Chief Executive Officer, to evaluate the operating performance of each segment.

Items excluded from Adjusted EBITDA

The process of refocusing and restructuring the businesses acquired in the KKR Acquisition and establishing the post-acquisition corporate entity, along with the impact of the acquisition of the specialty chemicals and advanced materials businesses of Dynamit Nobel and the Company s initial public offering, resulted in a number of charges that have affected Rockwood s historical results. These charges, along with certain other items, are added to or subtracted from income before taxes and minority interest to derive Adjusted EBITDA, as defined below. The more significant of these items include the following:

- *Systems/organization establishment expenses*. For the three and nine months ended September 30, 2006, expenses of $3.2 million and $7.3 million, respectively, were recorded related to professional fees incurred regarding systems and internal control documentation in connection with the Sarbanes-Oxley Act of 2002 and fees relating to the implementation of a new consolidation software system. For the three and nine months ended September 30, 2005, expenses of $1.4 million and $3.3 million, respectively, were recorded related to the integration of the businesses acquired in the Dynamit Nobel Acquisition, as well as professional fees incurred regarding systems and internal control documentation in connection with the Sarbanes-Oxley Act of 2002. We estimate non-recurring costs of approximately $0.7 million are remaining to complete initial Sarbanes-Oxley compliance.

• *Restructuring and related charges*. Restructuring charges of $1.7 million and $2.9 million were recorded in the three months ended September 30, 2006 and 2005, respectively, and $3.9 million and $9.2 million (which includes $0.5 million of charges recorded in the second quarter of 2005 in cost of products sold in the condensed consolidated statements of operations) in the nine months ended September 30, 2006 and 2005, respectively, for miscellaneous restructuring activities, including headcount reductions and facility closures (see Note 14, Restructuring Liability, for further details).

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• *Loss on sale of business*. In connection with the sale of Rohner AG in March 2006, the Company recorded a pre-tax loss of $12.1 million for the nine months ended September 30, 2006 (see Note 13, Sale of Rohner AG, for further detail).

• *Inventory write-up reversal*. Under SFAS 141, *Business Combinations*, all inventories acquired in an acquisition must be revalued to fair value. In connection with the Groupe Novasep combination in 2004, the acquisition of the Süd-Chemie businesses in 2005 and an acquisition in the Advanced Ceramics segment in 2006, the Company allocated a portion of the total purchase price to inventory to reflect manufacturing profit in inventory at the date of the acquisition. This resulted in a consequential reduction in gross profit, including currency effects, of $0.9 million and $3.1 million for the nine months ended September 30, 2006 and 2005, respectively, as the inventory was sold in the normal course of business

• *Chromated copper arsenate* (*CCA) litigation defense costs*. Costs of $0.3 million and income of $0.1 million were recorded in the three months ended September 30, 2006 and 2005, respectively, and costs of $0.8 million and $1.4 million were recorded in the nine months ended September 30, 2006 and 2005, respectively, primarily attorney fees related to the Company s Timber Treatment Chemicals business line of the Performance Additives segment.

• *Cancelled acquisition and disposal costs*. Costs of $0.4 million for the three months ended September 30, 2006 and costs of $1.3 million and $0.6 million for the nine months ended September 30, 2006 and 2005, respectively, were recorded in connection with non-consummated acquisitions and dispositions.

• *Foreign exchange gain (loss), net*. During the periods presented, the Company recorded foreign exchange gains and (losses) related to our long-term debt and other non-operating transactions. These amounts primarily reflect the non-cash translation impact on our euro-denominated debt resulting from the strengthening or weakening of the euro against the U.S. dollar and/or the British pound. For the three months ended September 30, 2006 and 2005, gains of $4.8 million and $2.1 million, respectively, were recorded. For the nine months ended September 30, 2006 and 2005, gains of $7.7 million and $116.1 million, respectively, were recorded. The decrease in the nine months ended September 30, 2006 from the same period in the prior year was primarily due to the designation of the majority of the Company s euro-denominated debt as a net investment hedge in October 2005 whereby foreign exchange gains and losses are now recorded in accumulated other comprehensive income within stockholders equity for the portion of the hedge that remains effective.

• *Management services agreement termination fee*. In connection with the IPO, an expense of $10.0 million was recorded in the third quarter of 2005 to terminate the management services agreement with affiliates of KKR and DLJMB.

• *Loss on early extinguishment of debt*. In the third quarter of 2005, the Company paid a redemption premium of $13.2 million to redeem long-term debt and wrote off $13.4 million of deferred financing costs associated with the debt repaid in connection with the IPO.

• *Other.* In the nine month period ended September 30, 2006, the Company recorded $2.1 million of income primarily related to the correction of an immaterial error reported in the first quarter of 2006 related to a previously unrecorded asset in the Titanium Dioxide segment of $1.6 million.

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 our 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. The indentures governing the 2011 Notes and the 2014 Notes exclude 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 before taxes and minority interest as the most comparable GAAP measure. The following table presents a reconciliation of income before taxes and minority interest to Adjusted EBITDA on a segment GAAP basis:

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($ in millions)	**Specialty Chemicals**	**Performance Additives**	**Titanium Dioxide Pigments**	**Advanced Ceramics**	**Groupe Novasep**	**Specialty Compounds**	**Electronics**	**Corporate**	**Consolidated**
Three months ended September 30, 2006									
Income (loss) before taxes and minority interest	$ 26.6	$ 14.4	$ 6.5	$ 8.9	$ 1.9	$ (1.1)	$ 6.1	$ (32.9)	$ 30.4
Interest expense, net (a)	9.7	3.7	7.3	7.8	3.8	7.1	0.1	21.3	60.8
Depreciation and amortization	11.7	11.8	9.5	8.3	8.2	1.9	3.7	1.0	56.1
Restructuring and related charges	0.6	0.3		0.6			0.2		1.7
CCA litigation defense costs		0.3							0.3
Systems/organization establishment expenses	(0.2)	0.6		0.4		0.3		2.1	3.2
Cancelled acquisition and disposal costs	0.1							0.3	0.4
Losses (gains) related to asset sales	0.3	0.1		(0.1)				(0.3)	
Foreign exchange loss (gain), net	0.2						(0.5)	(4.5)	(4.8)
Other		0.1	(0.1)	(0.1)				(0.4)	(0.5)
Total Adjusted EBITDA	$ 49.0	$ 31.3	$ 23.2	$ 25.8	$ 13.9	$ 8.2	$ 9.6	$ (13.4)	$ 147.6
Three months ended September 30, 2005									
Income (loss) before taxes and minority interest	$ 25.0	$ 19.2	$ 4.9	$ 8.2	$ (0.8)	$ 5.3	$ 2.9	$ (67.8)	$ (3.1)
Interest expense, net (a)	5.2	6.9	7.8	8.3	4.0	(0.7)	1.5	22.4	55.4
Depreciation and amortization	9.8	7.9	8.8	7.4	9.1	1.4	4.2	0.9	49.5
Restructuring and related charges	0.5	1.5		0.6	0.2		0.1		2.9
CCA litigation defense costs								(0.1)	(0.1)
Systems/organization establishment expenses		0.3						1.1	1.4
Management services agreement termination fee (c)								10.0	10.0
Loss on early extinguishment of debt (c)		1.1				0.6	0.3	24.6	26.6
Foreign exchange loss (gain), net	0.3				(0.2)		(1.3)	(0.9)	(2.1)
Other								(0.5)	(0.5)
Total Adjusted EBITDA	$ 40.8	$ 36.9	$ 21.5	$ 24.5	$ 12.3	$ 6.6	$ 7.7	$ (10.3)	$ 140.0
Nine months ended September 30, 2006									
Income (loss) before taxes and minority interest	$ 81.8	$ 60.2	$ 18.3	$ 25.3	$ 3.3	$ 10.6	$ 13.8	$ (79.5)	$ 133.8
Interest expense, net (a)	32.1	11.3	21.5	23.3	10.9	7.0	0.9	40.7	147.7
Depreciation and amortization	34.8	32.1	27.8	24.7	24.3	6.2	12.3	3.0	165.2
Restructuring and related charges	1.1	1.1		0.6			1.1		3.9
CCA litigation defense costs		0.8							0.8
Systems/organization establishment expenses	(0.1)	1.0		0.7		0.3		5.4	7.3
Cancelled acquisition and disposal costs	1.0							0.3	1.3
Inventory write-up reversal		0.8		0.1					0.9
(Gains) losses related to asset sales	0.3				(0.3)			(0.7)	(0.7)
Loss on sale of business					12.1				12.1
Foreign exchange loss (gain), net	0.4	0.1			(0.7)		(0.2)	(7.3)	(7.7)
Other	(0.3)		(1.7)	0.3				(0.4)	(2.1)
Total Adjusted EBITDA	$ 151.1	$ 107.4	$ 65.9	$ 75.0	$ 49.6	$ 24.1	$ 27.9	$ (38.5)	$ 462.5
Nine months ended September 30, 2005									
Income (loss) before taxes and minority interest	$ 69.0	$ 66.3	$ 12.9	$ 20.7	$ (7.0)	$ 17.2	$ 4.4	$ (19.7)	$ 163.8
Interest expense, net (a)	27.0	20.6	24.1	26.4	11.8	(0.8)	4.0	64.5	177.6
Depreciation and amortization	33.8	24.6	27.5	22.2	27.1	4.3	12.5	2.7	154.7
Restructuring and related charges (b)	1.6	4.7		0.6	0.2		2.1		9.2

CCA litigation defense costs		1.3						0.1	1.4
Systems/organization establishment expenses		0.3						3.0	3.3
Cancelled acquisition and disposal costs		0.2						0.4	0.6
Inventory write-up reversal					3.1				3.1
Management services agreement termination fee (c)								10.0	10.0
Loss on early extinguishment of debt (c)		1.1				0.6	0.3	24.6	26.6
Foreign exchange loss (gain), net	1.8	(0.8)		0.1	0.1		(2.8)	(114.5)	(116.1)
Other								(0.5)	(0.5)
Total Adjusted EBITDA	$ 133.2	$ 118.3	$ 64.5	$ 70.0	$ 35.3	$ 21.3	$ 20.5	$ (29.4)	$ 433.7

(a) Includes losses of $9.1 million and gains of $6.4 million for the three months ended September 30, 2006 and 2005, respectively, and gains of $6.4 million and $12.6 million for the nine months ended September 30, 2006 and 2005, respectively, representing the movement in the mark-to-market valuation of the Company s interest rate and cross-currency hedging instruments.

(b) Includes inventory writedowns of $0.5 million recorded in cost of products sold in the nine months ended September 30, 2005.

(c) In connection with the IPO, the management services agreement with the affiliates of KKR and DLJMB was terminated for $10.0 million. In addition, a redemption premium of $13.2 million was incurred in connection with the repayment of long-term debt and deferred financing costs of $13.4 million were written off.

5. ACQUISITIONS:

Since February 2002, pursuant to our business strategy of achieving profitable growth through selective acquisitions, we have acquired ten businesses at purchase prices ranging from approximately $3.0 million (a U.S. liquid pigments asset acquisition by our Performance Additives segment) to $2,290.3 million, including net debt assumed (the four businesses of Dynamit Nobel); and combined the three business lines of our Custom Synthesis segment (now known as Groupe Novasep segment) with the acquired businesses of Groupe Novasep SAS. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, any goodwill resulting from acquisitions is tested for impairment at least annually.

In December 2005, we completed an acquisition of the rheological additives and carbonless developers businesses of Süd-Chemie AG, Munich, Germany. Both businesses have been incorporated into Rockwood s Clay-based Additives business unit, which is part of the Performance Additives segment. We accounted for the acquisition of these businesses using the purchase method of accounting and have allocated the total estimated purchase price to the assets acquired and liabilities assumed. The allocation of the purchase price to the identifiable assets acquired was completed in the third quarter of 2006. The excess of the total purchase price over the estimated fair value of the net assets acquired at closing has been allocated to goodwill. Goodwill in the transaction totaled $9.8 million as of September 30, 2006.

In the first quarter of 2006, the Company recorded adjustments primarily relating to certain previously unidentified fixed assets acquired and an overstated pension accrual in connection with the Groupe Novasep combination and Dynamit Nobel Acquisition. These adjustments to the Company s purchase accounting resulted in an increase to property, plant and equipment, net of $10.9 million, an increase to deferred income tax liabilities of $3.7 million, and a decrease to pension liabilities of $4.0 million with a corresponding decrease in goodwill of $11.7 million. The effects of the adjustments to the Company s financial statements for the year ended December 31, 2005 are not material.

6. INVENTORIES:

Inventories are comprised of the following:

($ in millions)	September 30, 2006	December 31, 2005
Raw materials	$ 160.6	$ 141.6
Work-in-process	65.0	75.0
Finished goods	255.4	227.9
Packaging materials	13.0	13.7
	$ 494.0	$ 458.2

7. GOODWILL:

Below are goodwill balances and activity by segment:

($ in millions)	Specialty Chemicals	Performance Additives	Titanium Dioxide Pigments	Advanced Ceramics	Groupe Novasep	Specialty Compounds	Electronics	Total
Balance, December 31, 2005	$ 538.8	$ 459.5	$ 151.7	$ 187.5	$ 33.2	$ 109.2	$ 119.3	$ 1,599.2
Acquisitions				5.4				5.4
Other tax adjustments	(2.7)			(0.5)				(3.2)
Post-closing consideration and other related adjustments		(0.9)						(0.9)
Foreign exchange and other (a)	38.8	14.3	11.2	14.4	(5.8)	5.3	3.2	81.4
Balance, September 30, 2006	$ 574.9	$ 472.9	$ 162.9	$ 206.8	$ 27.4	$ 114.5	$ 122.5	$ 1,681.9

(a) Foreign exchange and other primarily consists of foreign currency changes and the adjustments described below.

The adjustments recorded during the first quarter of 2006 as disclosed in Note 5, Acquisitions, are recorded in foreign exchange and other, as reductions to goodwill within Specialty Chemicals ($4.0 million) and Groupe Novasep ($7.7 million).

8. OTHER INTANGIBLE ASSETS:

Other intangible assets, net consist of:

($ in millions)	As of September 30, 2006 Gross Carrying Amount (a)	Accumulated Amortization	Net	As of December 31, 2005 Gross Carrying Amount	Accumulated Amortization	Net
Patents and other intellectual property	$ 353.9	$ (83.7)	$ 270.2	$ 340.1	$ (64.3)	$ 275.8
Trade names and trademarks	124.4	(13.5)	110.9	114.3	(7.4)	106.9
Customer relationships	208.5	(35.3)	173.2	190.6	(20.9)	169.7
Other	52.8	(21.0)	31.8	47.2	(16.6)	30.6
Total	$ 739.6	$ (153.5)	$ 586.1	$ 692.2	$ (109.2)	$ 583.0

(a) The increase since December 31, 2005 is primarily due to foreign currency changes.

Amortization of other intangible assets was $16.1 million and $12.6 million for the three months ended September 30, 2006 and 2005, respectively, and $45.2 million and $39.3 million for the nine months ended September 30, 2006 and 2005, respectively. As of September 30, 2006, the estimated aggregate amortization expense for each of the five succeeding years is as follows:

($ in millions) Year ended	Amortization Expense
2006	$ 60.5
2007	60.6
2008	59.6
2009	52.6
2010	51.7

9. LONG-TERM DEBT

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

($ and in millions)	September 30, 2006	December 31, 2005
Senior secured credit facilities:		
Tranche A-1 term loans (35.2 and 39.1, respectively)	$ 44.6	$ 46.1
Tranche A-2 term loans (153.4 and 170.4, respectively)	194.4	201.0
Tranche E term loans	1,127.8	1,139.3
Tranche F term loans (270.7 and 273.4, respectively)	343.1	322.5
Revolving short-term loans		30.0
2011 Notes	273.4	273.4
2014 Notes (375.0 and $200.0 as of September 30, 2006 and December 31, 2005)	675.3	642.4
Other term loan facilities	54.2	92.7
Capitalized lease obligations (50.4 and 51.0, respectively)	63.9	61.2
Preferred stock of subsidiary (£12.0 as of September 30, 2006 and December 31, 2005)	22.5	20.6
Other (12.4 and 12.2, respectively)	15.7	14.6
	2,814.9	2,843.8
Less current maturities	(98.2)	(113.1)
	$ 2,716.7	$ 2,730.7

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, 2006, the Company had approximately $60.6 million of letters of credit and other bank guarantees, of which $36.0 million will expire in less than one year, $0.2 million will expire in 2-3 years, $7.9 million will expire in 4-5 years and $16.5

million will expire after five years. This amount includes outstanding letters of credit of $25.9 million

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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.

10. TAXES ON INCOME:

Income tax expense has been computed based on the projected effective tax rate for the year. The effective tax rate for the first nine months of 2006 and 2005 was 25.8% and 32.1%, respectively. The 2006 rate included a tax benefit of $21.8 million related to the favorable treatment on the sale of Rohner AG. The 2005 rate was favorably impacted by the reversal of $20.3 million of valuation allowances related to U.S. federal income generated. The effective tax rate for the third quarter of 2006 is 40.8%, which is primarily a function of foreign and domestic earnings and their impact on the effective tax rate. The Company recorded an income tax provision of $10.8 million in the third quarter of 2005 on a pre-tax loss of $3.1 million. Included in the tax provision in the third quarter of 2005 was the recording of a valuation allowance of $8.3 million on deferred tax assets for U.S. net operating loss carry-forwards.

In the nine months ended September 30, 2006, the Company reduced its worldwide valuation allowances by $16.2 million. The reduction in the valuation allowance was the result of a decrease in the net deferred tax assets of Rohner AG offset by an increase in the U.S. net deferred tax assets. The change in the valuation allowance for the third quarter of 2006 impacted the effective tax rate by $5.1 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, 2005	$ 77.1
Reduction in deferred tax assets of Rohner AG	(26.4)
Increase as reflected in income tax expense	6.0
Increase as reflected in other comprehensive income	4.5
Expired net operating loss	(0.3)
Balance as of September 30, 2006	$ 60.9

In the third quarter of 2006, based on the Company s policy and steady-state analysis, it was determined that there was not sufficient positive evidence of future taxable income in order to release the U.S. valuation allowance recorded in 2004. During the first nine months of 2006, the Company s net 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. 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.

11. EMPLOYEE BENEFIT PLANS:

The following table represents the net periodic benefit costs and related components in accordance with SFAS 132R, *Employers Disclosures about Pensions and Other Postretirement Benefits An Amendment of FASB Statements No. 87, 88 and 106*:

	Three months ended September 30,		**Nine months ended September 30,**	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Service cost	$ 2.4	$ 2.9	$ 7.7	$ 8.4
Interest cost	5.7	5.9	17.1	18.7
Expected return on assets	(2.0)	(2.2)	(6.6)	(7.6)
Net amortization of actuarial losses	0.6	0.2	2.0	0.6
Net periodic benefit cost	6.7	6.8	20.2	20.1
Special termination benefit cost		0.3		0.3
Impact of curtailment/settlement	0.5	1.2	0.5	1.2
Total pension cost	$ 7.2	$ 8.3	$ 20.7	$ 21.6

The curtailment/settlement costs for the three and nine months ended September 30, 2006 relate to settlements in the Rockwood UK Retirement Plan within the Performance Additives segment. The special termination benefit cost for the three and nine months ended September 30, 2005 relates to the closing of the Baulking, United Kingdom facility in the Clay-based Additives business within the Performance Additives segment. The curtailment/settlement costs for the three and nine months ended September 30, 2005 also relate to the closing of the Baulking facility and to pension costs incurred in connection with converting a specific defined benefit plan to a defined contribution plan in the Electronics segment.

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12. EARNINGS PER COMMON SHARE:

Basic and diluted 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, 2006	2005	Nine months ended September 30, 2006	2005
EPS Numerator - Basic:				
Net income (loss)	$ 21.4	$ (13.3)	$ 98.5	$ 113.6
Less:				
Redeemable convertible preferred stock dividends		(2.0)		(4.3)
Net income (loss) applicable to common shareholders	$ 21.4	$ (15.3)	$ 98.5	$ 109.3
EPS Denominator - Basic:				
Weighted average number of common shares outstanding	73,782	61,845	73,781	54,197
Basic earnings (loss) per common share	$ 0.29	$ (0.25)	$ 1.34	$ 2.02
EPS Numerator - Diluted:				
Net income (loss)	$ 21.4	$ (13.3)	$ 98.5	$ 113.6
Less:				
Redeemable convertible preferred stock dividends		(2.0)		(4.3)
Net income (loss) applicable to common shareholders	$ 21.4	$ (15.3)	$ 98.5	$ 109.3
EPS Denominator - Diluted:				
Weighted average number of common shares outstanding (a)	73,782	61,845	73,781	54,197
Effect of dilutive stock options and other incentives	1,133		1,220	895
Weighted average number of common shares outstanding and common stock equivalents	74,915	61,845	75,001	55,092
Diluted earnings (loss) per common share	$ 0.29	$ (0.25)	$ 1.31	$ 1.98

(a) Stock options, warrants and restricted stock representing equivalents of 4,838 shares of common stock during the three months ended September 30, 2005 were outstanding but were not included in the computation of diluted earnings per common share because their inclusion would not have had a dilutive effect. As a result, diluted loss per share for this period is equal to basic loss per share.

13. SALE OF ROHNER AG:

In late 2005, Rockwood had decided to substantially downsize the operations of Rohner AG (Rohner). This decision was driven by a number of factors, including, in particular, continued capacity utilization issues as a result of the loss of a key customer in 2003 and the inability to replace this lost volume with comparable profitable volume. The downsizing included a review of Rockwood s strategic options for this business including potential sale or closure. The Company had recorded a full impairment charge at the end of 2005 with respect to Rohner s long-term assets, primarily property, plant and equipment, totaling $44.7 million due to these actions. On March 9, 2006, after exploring several alternatives, the Company sold all of the capital stock of Rohner for a nominal price. Until that time, Rohner, located in Pratteln, Switzerland, had been a subsidiary in the Company s Groupe Novasep segment. Rohner produced chemicals on a custom-synthesis and toll manufacturing basis for the pharmaceutical and agrochemical industries, specializing in transition metal catalysis.

The Company recorded a net pre-tax loss of $12.1 million on the sale of Rohner in the first quarter of 2006, representing consideration given less the remaining net liabilities of Rohner, which have been transferred to the purchaser. The sale agreement contains a potential favorable purchase price adjustment of up to 5.0 million upon the achievement of certain operating targets of Rohner through 2008. The sale agreement also contains a potential unfavorable purchase price adjustment of 1.0 million. The Company has not included these potential purchase price adjustments in its determination of its net loss on the sale of Rohner as these adjustments were not probable at September 30, 2006.

Rockwood has reviewed whether the above activity should result in Rohner being treated as a discontinued operation and concluded that such treatment would not be appropriate as certain products will continue to be produced by other Groupe Novasep entities.

In addition, in connection with this downsizing, the Company had recorded for the year ended December 31, 2005 a minority interest charge of $13.9 million related to a guarantee, in an amount up to 55.0 million, entered into in May 2005 by one of our wholly-owned subsidiaries that is the 78.6% owner of Groupe Novasep SAS, of loans made by a Groupe Novasep SAS subsidiary to Rohner. At the time of the guarantee, the Company concluded the likelihood of having to fulfill this guarantee obligation was remote based on the limited term of the guarantee, the fact that the Company indirectly controlled the subsidiary receiving the guarantee and the expectation of continuing operations at Rohner. In connection with the preparation of the Company s 2005 financial statements, the Company concluded that it was probable that it would have to fulfill this guarantee obligation. Accordingly, the Company recorded the minority interest charge, based on the 21.4% minority interest in Groupe Novasep SAS not held by the Company. In October 2006, this guarantee obligation was settled for 35.0 million. As a result, minority interest income of approximately $3.3 million ($5.5 million before taxes) was recorded in the third quarter of 2006 as the final negotiated guarantee settlement was less than the amount that was originally contractually agreed upon.

14. RESTRUCTURING LIABILITY:

The Company records restructuring liabilities from time to time 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.

The Company recorded $1.7 million and $2.9 million of restructuring charges for the three months ended September 30, 2006 and 2005, respectively, and $3.9 million and $8.7 million of restructuring charges for the nine months ended September 30, 2006 and 2005, respectively. In addition, inventory writedowns of $0.5 million were recorded in cost of products sold in the second quarter of 2005 related to the restructuring of the Wafer Reclaim business in the Electronics segment.

2006 Restructuring Activities:

During the nine months ended September 30, 2006, the Company expensed $3.9 million of restructuring charges for miscellaneous restructuring actions, including $1.1 million for the announced restructuring of the Wafer Reclaim business in the Electronics segment. The Company recorded 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 the Performance Additives segment, $1.1 million was recorded for miscellaneous headcount reductions and the announced closure of the Baulking, United Kingdom facility for our Clay-based Additives business. In addition, $1.1 million was recorded in the Specialty Chemicals segment and $0.6 million was recorded in the Advanced Ceramics segment for miscellaneous headcount reductions.

Dynamit Nobel Restructuring and Johnson Matthey Pigments and Dispersions Restructuring

The Company began to assess and formulate specific plans to involuntarily terminate or relocate certain employees and/or exit certain activities of the Dynamit Nobel businesses as of the Dynamit Nobel Acquisition date. This assessment led to certain restructuring measures being taken by the Company as described below.

The Company closed the former corporate office of Dynamit Nobel located in Troisdorf, Germany in the fourth quarter of 2004. The Company recorded restructuring charges related to this closure including severance costs for 44 general and administrative personnel of the former Dynamit Nobel company, the closure costs on this building and the relocation costs for the remaining 27 employees who were relocated to the Company s new Frankfurt, Germany location. Also in 2004, as part of the acquisition of the Pigments and Dispersions business of Johnson Matthey, the Company enacted a restructuring program and 40 positions were eliminated. All of these employees were selling, general and administrative personnel.

Selected information for the 2006 restructuring actions follows:

($ in millions)	Severance Costs	Facility Closure Costs	Total
2006			
Liability balance, December 31, 2005	$	$	$
Restructuring charge in 2006	0.3	0.5	0.8
Utilized in 2006	(0.3)	(0.5)	(0.8)
Foreign exchange and other			
Liability balance, September 30, 2006	$	$	$

Selected information for the 2005 restructuring actions follows:

($ in millions)	Severance Costs	Facility Closure Costs	Total
2005			
Liability balance, December 31, 2005	$ 1.5	$ -	$ 1.5
Restructuring charge in 2006	0.9	1.1	2.0
Utilized in 2006	(1.3)	(1.3)	(2.6)
Foreign exchange and other	(0.4)	0.2	(0.2)
Liability balance, September 30, 2006	$ 0.7	$	$ 0.7

Selected information for the 2004 restructuring actions follows:

($ in millions)	Severance Costs	Facility Closure Costs	Relocation Costs	Total
2004				
Liability balance, December 31, 2005	$ 10.6	$ 1.1	$ 0.4	$ 12.1
Restructuring charge in 2006	1.0	0.1		1.1
Utilized in 2006	(5.0)	(1.0)		(6.0)
Foreign exchange and other	0.7			0.7
Liability balance, September 30, 2006	$ 7.3	$ 0.2	$ 0.4	$ 7.9

Restructuring reserves by segment are as follows:

($ in millions)	September 30, 2006	December 31, 2005
Specialty Chemicals	$ 3.8	$ 4.9
Performance Additives	0.8	1.1
Titanium Dioxide Pigments	0.3	0.3
Advanced Ceramics		0.5
Groupe Novasep		0.2
Specialty Compounds		
Electronics	0.1	0.7
Corporate	3.6	5.9
	$ 8.6	$ 13.6

At September 30, 2006 and December 31, 2005, restructuring reserves of $8.6 million and $13.6 million are included in the Condensed Consolidated Balance Sheets in restructuring liabilities.

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 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. Although the Company expects to continue to pay legal fees in connection with certain 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 such product liability matters do not individually exceed $500,000 and in the aggregate $3.0 million. 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 s insurance coverage, 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. In addition, the Company does not believe that there is any other individual legal proceeding that is likely to have a material adverse effect on its business or financial condition. However, the Company cannot predict the outcome of any litigation or the potential for future litigation.

Indemnity Matters Under the terms of the Business and Share Sale and Purchase Agreement, the Deed of Tax Covenant and the Environmental Deed entered into in connection with the KKR Acquisition, Degussa U.K. Holdings Ltd., as successor to Laporte Plc, is obligated to indemnify the Company for certain legal, tax and environmental liabilities and obligations that relate to the period prior to the closing of the KKR Acquisition. Under the terms of the Sale and Purchase Agreement with mg technologies ag (now known as GEA Group Aktiengesellschaft) and its subsidiary MG North America Holdings, Inc. (now known as GEA North America Inc.), GEA Group is 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 Degussa and GEA Group. In addition, the Company may be subject to indemnity claims relating to properties or businesses it divested. 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 will not have a material effect on the Company s financial condition, results of operations or cash flows.

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 Systems

The Company is committed to achieving and maintaining compliance with all applicable safety, health and environmental (SHE) legal requirements, and 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

The Company may incur future costs for capital improvements and general compliance under SHE laws. For the year ended December 31, 2005, the capital expenditures for SHE matters totaled approximately $32.8 million, excluding costs to maintain and repair pollution control equipment. For 2006 and 2007, 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

In October 2003, the European Commission adopted a proposal for a new EU framework for chemicals known as the Registration, Evaluation and Authorization of Chemicals, or REACH which will significantly expand the EU s regulation of chemicals. As currently proposed, REACH would include requirements that certain manufacturers and importers of chemicals register those chemicals, perform health and environmental risk analyses of those chemicals, and in certain instances, obtain authorizations for the use of the chemicals. Substances that are not registered within the prescribed deadlines will not be permitted to be manufactured or marketed within the EU. 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 over 400 products that might be subject to REACH, which is scheduled to become an EU directive in early 2007; compliance with REACH will be required starting in 2008.

Under the European Union Integrated Pollution Prevention and Control Directive (IPPC), EU member governments are to adopt rules and implement a cross-media (air, water and waste) environmental permitting program for individual facilities. IPPC requires a consistent application of Best Available Techniques, or BAT, throughout the EU. Generally, by 2007, facilities located within the EU must be operating consistent with BAT. While the EU countries are at varying stages in their respective implementation of the IPPC permit program, the Company has submitted all necessary IPPC permit applications required to date, and in some cases received completed permits from the applicable government agency. The Company expects to submit all other IPPC applications and related documents on a timely basis as the various countries implement the IPPC permit program. Although it is not known with certainty what each IPPC permit will require, the Company believes, based upon its experience with the permits received to date, that the costs of compliance with the IPPC permit program will not be material to its results of operations, financial position or liquidity.

The Kyoto Protocol is an amendment to an international treaty on global warming. The Protocol establishes significant emission reduction targets for six gases considered to have global warming potential, referred to as greenhouse gases. The Protocol was adopted in 1997 and became effective in February 2005 in over 140 countries that have ratified it. The EU, including Germany and other countries where the Company has interests, ratified the Kyoto Protocol in 2002 and, in doing so, have enacted regulations that reduce the emission of greenhouse gases and have established a trading system covering carbon dioxide emissions. Such a trading system became effective at the start of 2005. The new regulation directly affects our power plants at the Duisburg and Langelsheim sites in Germany, as well as the power plant being operated by a third party on one of our sites. Rockwood and such third party may be required to purchase carbon dioxide credits, which could result in increased operating costs, or may be required to develop additional cost-effective methods to reduce carbon dioxide emissions, which could result in increased capital expenditures. The new regulation indirectly affects our other operations in the EU, which may experience higher energy costs from third party providers. The Company continues to evaluate options in order to comply with the Protocol. However, we do not expect this to have a material impact on our cash flow or results of operations.

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.

Environmental contamination is known to exist at certain of the Company s present and former facilities, including its facilities located in Turin, Italy; St. Fromond, St. Cheron and Sens, France; Hainhaussen, Troisdorf, Schlebusch, Stadeln, Duisburg, Plochingen, Marktredwitz, Ronnenberg-Empelde and Langelsheim, Germany; Oss, The Netherlands; Kidsgrove, Sudbury and Barrow, U.K.; Boksburg East, South Africa and in the United States, in Valdosta, Georgia, Beltsville, Maryland, Louisville, Kentucky, New Johnsonville, Tennessee, Harrisburg, North Carolina, Laurens, South Carolina, Silver Peak, Nevada and La Mirada, California. Soil contamination is also known to exist at the Company s facilities at Freeport, Texas, Chasse-sur-Rhone, France, Sudbury, U.K. and Sumperk in Czech Republic; however, no further regulatory remedial actions are currently required for these facilities and any liabilities arising from such contamination is covered by indemnity obligations or the previous owners of these facilities with the exception of Freeport. The Company is currently operating groundwater remediation systems at its Hainhaussen, Stadeln, Valdosta, and Silver Peak facilities. The Company also operates groundwater remediation and/or monitoring systems at its Schlebusch, Plochingen, Marktredwitz, Stadeln, Troisdorf, New Johnsonville, Tennessee and Laurens facilities, for which prior owners or insurers have assumed responsibility. The Company also continues to monitor groundwater at the Beltsville and St. Cheron facilities, which were previously the subject of a soil removal action. Groundwater is also monitored at the St. Fromond and Barrow facilities due to prior spills and at the Harrisburg and Louisville facilities due to a landfill closure. The Company is also required to monitor

groundwater quality at its facility at Mourenx, France. The Company believes that additional environmental studies, and possibly environmental remediations, will be required at the Harrisburg facility. The Company is also in the process of determining appropriate remedial actions with the regulatory authorities at the following locations: Duisburg, Langelsheim, Troisdorf, Turin and La Mirada. Furthermore, as a result of facility closings, divestitures and offsite disposal activities, the Company is responsible for the following other matters: contamination beneath divested portions of the manufacturing facility in Troisdorf; a former disposal site in Laurel, Maryland; contamination at a closed Specialty Chemicals facility in Houston, Texas; contamination at a former Specialty Chemicals facility in Sunbright, Virginia; groundwater remediation at Stadeln; and former sites operated by Dynamit Nobel s previously divested explosives business. The Company is also a *de minimis* participant in several Superfund matters.

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 and the Company s predecessor s former and present properties and/or at sites 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 Saint Louis, Missouri to reduce ammonia concentrations in wastewater discharge to a city treatment plant. MSD s new National Pollution Discharge Elimination System (NPDES) permit will require the Company to reduce the facility s ammonia discharge by an average of 50% by December 31, 2008. The Company is evaluating various options to reduce the amount of ammonia discharge. Although the Company will be required to make capital expenditures in connection with this matter, it does not believe that this issue will have a material adverse effect on its business or financial condition.

Environmental Indemnities

Pursuant to the environmental deed entered into in connection with the KKR Acquisition, Degussa, as successor to Laporte, is required to indemnify the Company and its subsidiaries for certain environmental matters that relate to the business as conducted prior to the closing of the KKR Acquisition. The environmental deed provides that Degussa will indemnify the Company and its subsidiaries for claims for which notice is given within a period of two years for breaches of representations and warranties, which expired in 2002, and five years, which expired in September 2005, for claims related to the contamination of the Company s properties or its subsidiaries properties (inclusive of contamination which leaks or escapes from the Company s properties or its subsidiaries properties). These indemnity obligations are subject to a minimum per matter loss of $0.2 million and are further subject to a $5.0 million deductible for the indemnity to be available. In addition, the environmental deed provides that Degussa will indemnify Rockwood and its subsidiaries for claims relating to properties that were formerly owned, occupied or used as of November 20, 2000, as well as properties owned by third parties (inclusive of disposal of waste and certain other identified issues prior to November 20, 2000). The environmental deed provides that in this instance, Degussa will be responsible for reasonable costs and expenses incurred.

In addition, pursuant to the sale and purchase agreement entered into in connection with the Dynamit Nobel Acquisition, mg technologies ag (now known as GEA Group Aktiengesellschaft) and its subsidiary, MG North America Holdings, Inc. (now known as GEA North America, Inc.), are required to indemnify Rockwood and its subsidiaries for 50% of the excess amount of losses over the amount of the related reserves (in the case of known claims) and 50% of claims (in the case of unknown claims) related to the contamination of the Company or its subsidiaries properties, if notified within ten years. If GEA Group s and GEA North America s responsibility for contamination matters cannot be proven, a sliding scale reduces the percentage further for each year during the five-year period from year six to ten. GEA Group and GEA North America are also obligated to indemnify the Company for 85% of claims related to legacy site matters, such as environmental matters relating to properties or businesses owned or operated by Dynamit Nobel prior to, but not on, the closing of the Dynamit Nobel Acquisition, if notified within ten years. In addition, GEA Group and GEA North America are obligated to indemnify the Company for 50% of the excess amount of losses over the amount of the related reserves for operational compliance matters, if notified by December 31, 2006, and 50% of the excess amount of losses over the amount of the related reserves (in the case of known claims) and 50% of claims (in the case of unknown claims) related to certain environmental damage claims unknown at the time of the closing of the Dynamit Nobel Acquisition, if notified within ten years. All of these indemnity obligations are subject to different minimum per-claim thresholds depending on whether the matter was disclosed or not, and on the subject matter, ranging between 100,000 and 750,000 ($126,740 and $950,550 using the September 30, 2006 exchange rate of 1.00 = $1.2674) depending on the type of claim. The indemnity obligations are further subject to certain deductibles, exclusions and limitations. Furthermore, GEA Group and GEA North America are obligated to indemnify the Company for certain environmental risks arising from certain shared site structures for a duration of ten years. This indemnity obligation is not subject to the percentages, *de minimis* exclusions, deductibles and thresholds described above, and it is not subject to most of the general limitations.

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In the event the Company seeks indemnity under any of these agreements or through other means, there can be no assurance that GEA Group, GEA North America, Degussa or any other 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 addition, the Company may be required to make indemnity payments in connection with certain environmental matters. However, the Company does not believe that resolution of the known environmental matters subject to indemnification obligations owed to it or by it will have a material adverse effect on the Company s business or financial condition, but may have a material adverse effect on the results of operations or cash flow in any given quarterly or annual reporting period.

Environmental Reserves

The Company has established reserves relating to anticipated environmental cleanup obligations, site reclamation and remediation and closure costs. Liabilities are recorded when potential liabilities are either known or believed to be probable and can be reasonably estimated. The Company s liability estimates are based upon available facts, existing technology, past experience and, in some instances insurance recoveries where the remediation costs are being paid directly by the Company s 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 accrued approximately $36.5 million and $44.8 million for known environmental liabilities as of September 30, 2006 and December 31, 2005, respectively, all of which are classified as other non-current liabilities on the Company s consolidated balance sheets for such periods. Included in the $36.5 million and $44.8 million as of September 30, 2006 and December 31, 2005, respectively, is 6.5 million ($8.2 million using the September 30, 2006 exchange rate of 1.00 = $1.2674) that is discounted using a 5.0% discount rate (undiscounted amount equals $12.6 million), and 1.9 million ($2.4 million) that is discounted using a 5.5% discount rate (undiscounted amount equals $3.1 million). In certain cases, the Company s remediation liabilities are payable over periods of up to 30 years. At December 31, 2005, the environmental reserve related to the Rohner facility within our Groupe Novasep segment was $10.5 million. As discussed, Rohner AG was sold in March 2006 (see Note 13, Sale of Rohner AG, for further detail).

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 the Company does not believe the additional amount of potential losses would have a material effect on the Company s results of operations or financial condition, but may have a material adverse effect on the results of operations or cash flow in any given quarterly or annual reporting period. 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.

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 our other facilities with known contamination, regulatory authorities may impose more stringent requirements on us 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 the obligations. Consequently, the Company cannot employ a present value technique to estimate fair value and, accordingly, it has not accrued for any environmental related costs to remediate soil at these facilities.

The Company believes these environmental matters will not have a material adverse effect on its business or financial condition. However, these matters may have a material adverse effect on its results of operations or cash flows in any given quarterly or annual reporting period.

16. RESTATEMENT:

The condensed consolidated statements of cash flows as reported for the nine months ended September 30, 2005, contained a classification error in the treatment of costs of property, plant and equipment included in accounts payable and accrued expenses and other liabilities. In accordance with SFAS No. 95, *Statement of Cash Flows,* these costs should be reported within cash flows from investing activities when paid. The Company was reporting capital expenditures in its condensed consolidated statements of cash flows on an accrual basis rather than on a cash basis, and as a result, was reporting capital expenditures in the period in which the Company acquired legal title to the related property, plant and equipment rather than when the Company actually paid for such property, plant and equipment. Further, the unpaid portion of the transaction should be disclosed as a non-cash investing activity in the supplemental disclosure of cash flow information. As a result, the Company restated the condensed consolidated statement of cash flows for the nine months ended September 30, 2005. The restatement does not change the Company s condensed consolidated statements of operations, the condensed consolidated balance sheets or cash and cash equivalents reported at the end of the period in the condensed consolidated statements of cash flows for any of the periods presented.

The classification error changed cash flow from operating activities and investing activities for the nine months ended September 30, 2005 as follows (in millions):

Description	As Originally Reported	As Restated
CASH FLOWS FROM OPERATING ACTIVITIES:		
Accounts payable	$ 20.6	$ 35.2
Accrued expenses and other liabilities	(21.3)	(19.6)
Net cash provided by operating activities	182.6	198.9
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures, excluding capital leases	(123.0)	(139.3)
Net cash used in investing activities	(138.9)	(155.2)
NON-CASH INVESTING ACTIVITIES:		
Decrease in liabilities for property, plant and equipment		(16.3)

The Company also revised the reconciliation of net cash provided by operating activities to Adjusted EBITDA and the disclosures in the Liquidity and Capital Resources section of Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, related to cash flows from operating and investing activities for the nine months ended September 30, 2005.

17. SUBSEQUENT EVENTS:

In October 2006, Rohm and Haas Company and Chemical Specialties, Inc. (CSI), a wholly owned subsidiary of the Company, announced their plans to form a joint venture company to provide an extensive range of advanced wood treatment technologies and services to the global wood treatment industry. The joint venture would bring together the wood biocides business of Rohm and Haas and the wood protection chemicals business of CSI. Further details of this announced joint venture are included in a Form 8-K filed by the Company on October 12, 2006. The parties executed a definitive agreement in November 2006 and expect the transaction to close in early January 2007. This transaction is subject to government review.

In October 2006, the Company announced that it was considering divesting the Groupe Novasep segment. The Company is currently evaluating its alternatives.

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

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 2005 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. The following management s discussion and analysis of financial condition and results of operations gives effect to the restatement as described in Note 16, Restatement.

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. Since the completion of the Dynamit Nobel Acquisition, we operate through seven business segments: (1) Specialty Chemicals; (2) Performance Additives; (3) Titanium Dioxide Pigments; (4) Advanced Ceramics; (5) Groupe Novasep; (6) Specialty Compounds; and (7) Electronics. Of these seven segments, we acquired Specialty Chemicals, Titanium Dioxide Pigments, Advanced Ceramics and Groupe Novasep (then known as our Custom Synthesis segment) in the Dynamit Nobel Acquisition.

Our net sales consist of sales of our products, net of sales discounts, product returns and allowances. 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.

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 and debt reduction. In connection with this focus, among other things:

- We have cut costs, reduced overhead and eliminated duplicative positions in the acquired Dynamit Nobel businesses and the acquired pigments and dispersions business of Johnson Matthey Plc. For example, we closed the former headquarters of Dynamit Nobel in Troisdorf, Germany and closed the New Lebanon, New York manufacturing facility of our Advanced Ceramics segment. In addition, we eliminated 40 positions in connection with the acquisition of the pigments and dispersions business. In the Wafer Reclaim business in our Electronics segment, we closed a facility in the U.K. in January 2006 and closed one of our facilities in the U.S. in March 2006. In our Groupe Novasep segment, we sold our Rohner AG operation located in Pratteln, Switzerland in March 2006. We also implemented other restructuring measures in our other segments;

- We reduced our net working capital as a percentage of net sales by implementing more effective systems to monitor working capital, augmenting further our just-in-time inventory management and creating incentives for managers to focus on working capital management; and

- We implemented stringent controls to help ensure that maintenance capital expenditures are appropriate and that expansion capital is in line with both capacity and market demands. We closely monitor capital expenditures in all of our segments.

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. In 2005, we benefited from a growth in demand for most of the markets and regions we serve, especially in the aerospace and automotive industry which has continued in 2006. Despite the less favorable automotive conditions in the U.S., we have been able to sustain sales growth in our global automotive business due to market penetration as our business primarily focuses on the European automobile industry market. Growth in the Surface Treatment business occurred in the first nine months of 2006 and is expected to continue this year in most markets as price and volume increases and productivity improvements are expected to offset raw material cost increases.

- Demand for our lithium products in the Fine Chemicals business line of our Specialty Chemicals segment is generally driven in part by demand of 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. Market conditions for lithium products in the industries served provided increasing price trends for lithium salts in 2005. Growth in the Fine Chemicals business has occurred in the first nine months of 2006 and is expected to continue this year in most market segments, especially driven by lithium salt applications through price increases. Tight supplies in the global market and unfavorable weather conditions at our lithium ponds in Chile early this year have lead to shortages in lithium salts as a raw material and customer demand for lithium carbonate will not be completely satisfied. During 2005, we experienced price increases related to key raw materials used in producing metal sulfides. In the first nine months of 2006, prices for some raw materials have increased further. Raw material prices are expected to be volatile throughout the remainder of the year.

Performance Additives

• Although the growth in demand in certain North American end-use markets, such as construction, has slowed, sales in our Color Pigments and Services business in North America have increased on higher construction volumes and selling price increases that were necessary to recover raw material and energy cost increases. Generally, a continuing trend towards the increased use of colored concrete products in the North American construction market has had a positive effect on our Color

Pigments and Services business line. The Timber Treatment Chemicals business also benefited from high levels of activity in home improvement areas; however, demand for treated wood has been negatively impacted in 2006 by the increasing use of wood substitutes and a slowdown in the construction market.

- Demand in certain European end-use markets over the last few years has slowed. This affected sales of Color Pigments and Services in the construction market. We experienced a decrease in European construction volumes in our Color Pigments and Services business in 2005. European construction sales in our Color Pigments and Services business decreased slightly in the first nine months of 2006 versus the same period in the prior year as the lower volumes were partially offset by higher selling prices necessary to recover raw material and energy cost increases.

- The change in the market to environmentally advanced wood treatment chemical products, such as ACQ, and the phase out of chromated copper arsenate, or CCA, for residential use had a positive impact on our Timber Treatment Chemicals business in 2005, which is a leading supplier of these higher margin products. However, in the Timber Treatment Chemicals business, our ACQ market position has been negatively impacted by market share losses to competition and competitive pricing pressure. In addition, the expiration of the ACQ patent in 2007 could have a negative impact on our ACQ market position, sales and margins.

- Our Clay-based Additives business supplies specialty rheology modifiers and additives, both clay-based and synthetic, to a variety of end-use markets. For 2006, the major drivers of expected growth in the Clay-based Additives business have been the acquisition of Süd-Chemie s Rheological Additives and carbonless clay businesses, which closed on December 30, 2005, continued strength in oilfield sales and growth in additives for water-based coatings.

- Raw material costs increased in general in the Performance Additives segment in 2005 and continue to trend upward. In the Color Pigments and Services business, selling price increases were initiated in 2005 to partially offset the increases in raw material and energy costs. In the first nine months of 2006, selling price increases continued to be implemented to offset raw material and energy cost increases. For the first nine months of 2006 in the Timber Treatment Chemicals business, there have been increased raw material costs for copper, which have been at record highs in 2006, compared to the same period in 2005, and mono-ethanolamine, primary components in the ACQ production process. These increased raw material costs were not passed on to customers in 2006. In the Clay-based Additives business, price increases were implemented in 2005 in selective product lines and continued in 2006 in a majority of product lines to partially offset energy and raw material cost increases.

- In October 2006, Rohm and Haas Company and Chemical Specialties, Inc. (CSI), a wholly owned subsidiary of the Company, announced their plans to form a joint venture company to provide an extensive range of advanced wood treatment technologies and services to the global wood treatment industry. The joint venture would bring together the wood biocides business of Rohm and Haas and the wood protection chemicals business of CSI. Further details of this announced joint venture are included in a Form 8-K filed by the Company on October 12, 2006. The parties executed a definitive agreement in November 2006 and expect the transaction to close in early January 2007. This transaction is subject to government review.

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, paper and plastics industries. We experienced an unexpected decrease in volume of our titanium dioxide products in anatase grade in 2005 due, in part, to the lower cost of cotton, which negatively affected demand for synthetic fibers and in turn our products. However, volumes in the fiber anatase business have increased in the first nine months of 2006 and are expected to continue to increase.

- Throughout 2005, we experienced pricing pressure from global suppliers in Asia, specifically Chinese suppliers related to titanium dioxide products in anatase grade. We also experienced pricing pressures on our titanium products in rutile grade. Sales of titanium dioxide products in rutile grade increased in the first nine months of 2006 on higher selling prices and are expected to be above the prior year level for the full year.

Advanced Ceramics

- Demand for our ceramic medical devices is mainly tied to the aging population in Europe and the United States. As a result of this demographic as well as our market share penetration, the volume of our products used in medical device applications sold has experienced double-digit growth each year from 2001 through 2005. However, in 2006 some customers in the U.S. reduced their demand due to high inventory levels and delayed approvals. As a result, this demand has stabilized.

- Sales of ceramic products for use in cutting tool products and mechanical systems were negatively impacted by pricing pressure from Asian competitors in 2005 and 2006 and is expected to continue. In addition, selling prices in our electronic products business as well as for some Piezo applications were lower in the first nine months of 2006 and are expected to continue to be lower for the remainder of this year.

Groupe Novasep

- Demand for our custom synthesis and proprietary product chemistries and processes depend on the pipeline and lifecycles of pharmaceuticals. While slowdown of new drug approval in the U.S. is affecting our market, the number of drugs that are becoming generic is contributing to growth. Healthcare cost containment policies put pressure on prices and this adversely affects the prices of our products. However, this also creates opportunities for innovative synthesis routes and purification and separation processes.

- China and India are emerging countries in this market and represent competition for our custom synthesis chemistries. This competition is also contributing to sales growth in our process business for equipment, processes and systems in these countries. In addition, the growing worldwide population and the aging population in the U.S., Europe and Japan have increased demand for pharmaceuticals.

- The demand for green industrial processes that release less solvents/effluents creates continuous and profitable growth opportunities for our industrial biotech business as oil derivative products are being replaced by others coming from agriculture such as biofuels. The increasing price of crude oil also has a positive impact in the industrial biotech market.

- In October 2006, the Company announced that it was considering divesting the Groupe Novasep segment. The Company is currently evaluating its alternatives.

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. In 2005, we experienced increased demand for these products. Volumes for these wire and cable products have stabilized in 2006. Newly developed non-halogen products for wire and cable data communication, military and other applications have expanded business in North America and created opportunities in Europe.

- 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. Our net sales in these markets were up slightly in 2005 and thus far in 2006. We are focusing more of our efforts towards increasing high margin specialty products to offset this impact, in particular, thermoplastic elastomers, and less of our efforts in regulated packaging and footwear.

- Raw material costs trended upward in 2005; in particular, the Specialty Compounds segment experienced a spike in raw material costs as a result of Hurricanes Katrina and Rita. The price of ammonium octamolybdate (AOM) and polyvinyl chloride (PVC) resin and plasticizers, key raw materials used in the production of wire and cable products, increased in 2005. As a result, we entered into a contract with a fixed price for AOM purchases that expires in December 2007. Prices for these raw materials were higher in the first nine months of 2006 compared to the same period in 2005. Selling price increases were successfully initiated in 2005 to help offset the raw materials price increase and have continued in 2006 to help compensate for the higher raw material costs. However, the ability to pass on some or all of these increases is uncertain.

Electronics

- Demand for our Electronics products generally follows the activity levels of semiconductor and printed circuit board manufacturers. The global semiconductor and printed circuit board (PCB) markets are cyclical in nature. Worldwide sales of semiconductors increased in 2006 over the same period in 2005 and we expect sales to continue to rise in 2006 driven by strong demand for consumer electronics, cell phones and PC s. The printed circuit board industry in the United States and Europe continued to decline in 2005 while the market in Asia experienced significant growth. Despite the declines in the United States and Europe, volumes in our electronic chemicals business increased in 2005, and are expected to continue to increase throughout 2006, particularly in Asia, which provides nearly half of the global market. In the first nine months of 2006, volumes in our electronic chemicals business were up in all regions.

- The price of certain of our products is insulated to some degree from the effect of changes in the price of semiconductors and printed circuit boards due to the fact that the cost of these products is generally a small component of the cost of the end product. Despite this, in 2005 and continuing into 2006, there has been pricing pressure in certain businesses, particularly photomasks due to very aggressive competition. We expect that this pricing pressure will continue during the rest of 2006 for the photomasks businesses.

Global Exposure

We operate a geographically diverse business. Of our 2005 net sales, 51% were shipments to Europe, 33% to North America (predominantly the United States) and 16% 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 2005 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 over 100 manufacturing facilities in 25 countries. Consequently, we are exposed to global economic and political changes, particularly currency fluctuations that could impact our profitability.

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 nine month period ended September 30, 2006, the average exchange rate of the euro against the U.S. dollar was lower compared to the same period in 2005 and negatively impacted our net sales, gross profit and operating income. For the three months ended September 30, 2006, the average exchange rate of the euro against the U.S. dollar was higher compared to the same period in 2005 and had a positive impact on our net sales, gross profit and operating income. The euro was stronger at September 30, 2006 compared to December 31, 2005. 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, particularly in our Groupe Novasep segment.

Raw Materials

Raw materials constituted approximately 49% of our 2005 cost of products sold. We have a broad raw material base, with the cost of no single raw material representing more than 2% of our cost of products sold in 2005. 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. In particular, record high prices for copper used in the Timber Treatment Chemicals business of our Performance Additives segment have had a negative impact on results. 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.

Energy Costs

In 2005, 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 increased in 2005, due in part to political conditions and extreme weather conditions, including Hurricanes Katrina and Rita. Natural gas prices have been relatively stable thus far in 2006. In contrast, natural gas prices in Europe, where our Titanium Dioxide Pigments segment is located, have historically been relatively stable, although prices rose in the first nine months of 2006.

Income Taxes

The effective tax rate for the third quarter of 2006 was 40.8% which is primarily a function of foreign and domestic earnings and their impact on the effective rate. In the third quarter of 2006, the worldwide valuation allowance increased by $3.2 million. The increase in the valuation allowance was primarily due to an increase of $5.1 million in deferred tax assets associated with the Company s losses partially offset by a reduction of $1.9 million in other comprehensive income. The $5.1 million increase in the valuation allowance for the third quarter of 2006 impacted the effective tax rate.

Special Charges and Credits

During the periods presented, we incurred certain special charges, along with certain other items, substantially in connection with the establishment of the post-acquisition corporate entity that incorporates the four business segments acquired in the Dynamit Nobel Acquisition as well as in connection with the IPO. These items include systems/organization establishment expenses, restructuring and related charges, foreign exchange gains and losses and inventory write-up reversals. See Items excluded from Adjusted EBITDA section in Note 4, Segment Information, for a discussion of special charges and credits recorded in the three and nine months ended

September 30, 2006 and 2005.

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

All presentations of consolidated Adjusted EBITDA contained in this report are calculated using the definition set forth in the senior secured credit agreement. 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.

With respect to entities acquired, we include Adjusted EBITDA for such entities in calculating our pro forma Adjusted EBITDA. The adjustments made to the income from continuing operations before income taxes and extraordinary items of such entities directly correlate to the adjustments to net income in calculating Adjusted EBITDA on a consolidated basis pursuant to the senior secured credit agreement.

For presentation purposes within this report, we consistently use the computation prescribed under our senior secured credit agreement as described above. Specifically, calculation of Adjusted EBITDA according to the indentures underlying our 2011 Notes and 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 vest, both 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 indentures governing the 2011 Notes and 2014 Notes contain financial covenants that are determined based on Adjusted EBITDA. These covenants are material terms of these agreements, which are material 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 2011 Notes and the 2014 Notes. In addition, if we cannot satisfy these financial covenants in the indentures governing the 2011 Notes and 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 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.

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) 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 GAAP financial measures and other financial information, in each case included elsewhere in this report. We also strongly urge you not to rely on any single financial measure to evaluate our business.

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, 2006 and 2005), including as a percentage of net sales, for the periods presented. See Note 4, Segment Information, for segment information and a reconciliation to net income on a consolidated basis and a reconciliation to income before taxes and minority interest on a segment basis.

($ in millions)	Three months ended September 30, 2006		2005		Nine months ended September 30, 2006		2005	
Statement of operations data:								
Net sales:								
Specialty Chemicals	$ 225.5		$ 202.6		$ 685.6		$ 642.3	
Performance Additives	192.4		170.7		587.7		520.3	
Titanium Dioxide Pigments	111.2		106.6		330.4		320.3	
Advanced Ceramics	95.6		95.3		286.3		283.6	
Groupe Novasep	87.2		92.0		260.0		279.9	
Specialty Compounds	62.1		57.6		191.4		177.8	
Electronics	53.0		46.9		154.0		134.6	
Total net sales	827.0		771.7		2,495.4		2,358.8	
Gross profit	247.3		233.5		765.9		722.1	
	29.9	%	30.3	%	30.7	%	30.6	%
Selling, general and administrative expenses	159.5		143.8		478.8		451.5	
	19.3	%	18.6	%	19.2	%	19.1	%
Restructuring charges, net	1.7		2.9		3.9		8.7	
Management services agreement termination fee			10.0				10.0	
Operating income (loss):								
Specialty Chemicals	36.6		30.5		114.5		97.8	
	16.2	%	15.1	%	16.7	%	15.2	%
Performance Additives	18.2		27.2		71.7		87.2	
	9.5	%	15.9	%	12.2	%	16.8	%
Titanium Dioxide Pigments	13.7		12.7		38.1		37.0	
	12.3	%	11.9	%	11.5	%	11.6	%
Advanced Ceramics	16.7		16.5		48.6		47.2	
	17.5	%	17.3	%	17.0	%	16.6	%
Groupe Novasep	5.9		3.0		25.4		4.9	
	6.8	%	3.3	%	9.8	%	1.8	%
Specialty Compounds	6.0		5.2		17.6		17.0	
	9.7	%	9.0	%	9.2	%	9.6	%
Electronics	5.7		3.4		14.5		5.9	
	10.8	%	7.2	%	9.4	%	4.4	%
Corporate costs	(16.7	)	(21.7	)	(47.2	)	(45.1	)
Total operating income	86.1		76.8		283.2		251.9	
Other income (expenses):								
Interest expense, net	(60.8	)	(55.4	)	(147.7	)	(177.6	)
Loss on early extinguishment of debt			(26.6	)			(26.6	)
Foreign exchange gain, net	4.8		2.1		7.7		116.1	
Loss on sale of business					(12.1	)		
Other, net	0.3				2.7			
Income (loss) before taxes and minority interest	30.4		(3.1	)	133.8		163.8	
Income tax provision	12.4		10.8		34.5		52.5	
Income (loss) before minority interest	18.0		(13.9	)	99.3		111.3	
Minority interest	3.4		0.6		(0.8	)	2.3	
Net income (loss)	$ 21.4		$ (13.3	)	$ 98.5		$ 113.6	
Adjusted EBITDA:								
Specialty Chemicals	49.0		40.8		151.1		133.2	
	21.7	%	20.1	%	22.0	%	20.7	%
Performance Additives	31.3		36.9		107.4		118.3	
	16.3	%	21.6	%	18.3	%	22.7	%
Titanium Dioxide Pigments	23.2		21.5		65.9		64.5	
	20.9	%	20.2	%	19.9	%	20.1	%
Advanced Ceramics	25.8		24.5		75.0		70.0	
	27.0	%	25.7	%	26.2	%	24.7	%

Groupe Novasep	13.9	12.3	49.6	35.3
	15.9 %	13.4 %	19.1 %	12.6 %
Specialty Compounds	8.2	6.6	24.1	21.3
	13.2 %	11.5 %	12.6 %	12.0 %
Electronics	9.6	7.7	27.9	20.5
	18.1 %	16.4 %	18.1 %	15.2 %
Corporate costs	(13.4)	(10.3)	(38.5)	(29.4)
Total Adjusted EBITDA	$ 147.6	$ 140.0	$ 462.5	$ 433.7

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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, 2006 versus 2005				Change: Nine months ended September 30, 2006 versus 2005			
($ in millions)	Total	% Change	FX Effect (a)	Organic (b)	Total	% Change	FX Effect (a)	Organic (b)
Statement of operations data:								