Rockwood Holdings, Inc.
Form 10-Q
August 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 June 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 August 10, 2006, there were 73,780,526 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 June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 30, 2005
NET SALES	$ 855.8	$ 817.4	$ 1,668.4	$ 1,587.1
COST OF PRODUCTS SOLD	586.9	554.4	1,149.8	1,098.5
GROSS PROFIT	268.9	263.0	518.6	488.6
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	162.3	157.5	319.3	307.7
RESTRUCTURING CHARGES, net	1.0	2.9	2.2	5.8
OPERATING INCOME	105.6	102.6	197.1	175.1
OTHER INCOME (EXPENSES):				
Interest expense, net	(47.8)	(64.9)	(86.9)	(122.2)
Foreign exchange gain, net	5.5	66.8	2.9	114.0
Loss on sale of business			(12.1)	
Other, net	0.2		2.4	
Net	(42.1)	1.9	(93.7)	(8.2)
INCOME BEFORE TAXES AND MINORITY INTEREST	63.5	104.5	103.4	166.9
INCOME TAX PROVISION	25.2	16.8	22.1	41.7
NET INCOME BEFORE MINORITY INTEREST	38.3	87.7	81.3	125.2
MINORITY INTEREST	(1.2)	0.9	(4.2)	1.7
NET INCOME	$ 37.1	$ 88.6	$ 77.1	$ 126.9
Per share data:				
BASIC EARNINGS PER COMMON SHARE	$ 0.50	$ 1.74	$ 1.04	$ 2.48
DILUTED EARNINGS PER COMMON SHARE	$ 0.49	$ 1.68	$ 1.03	$ 2.41
WEIGHTED AVERAGE NUMBER OF BASIC SHARES OUTSTANDING	73,781	50,310	73,780	50,310
WEIGHTED AVERAGE NUMBER OF DILUTED SHARES OUTSTANDING	75,111	52,732	75,041	52,657

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)

	June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 36.6	$ 102.2
Accounts receivable, net	552.9	484.2
Inventories	483.7	458.2
Deferred income taxes	10.7	12.2
Prepaid expenses and other current assets	60.5	68.1
Total current assets	1,144.4	1,124.9
PROPERTY, PLANT AND EQUIPMENT, net	1,500.9	1,406.5
GOODWILL	1,690.4	1,599.2
OTHER INTANGIBLE ASSETS, net	598.8	578.9
DEFERRED DEBT ISSUANCE COSTS, net of accumulated amortization of $19.1 and $13.5, respectively	55.2	56.6
OTHER ASSETS	56.8	44.0
TOTAL ASSETS	$ 5,046.5	$ 4,810.1
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 273.5	$ 295.7
Income taxes payable	32.8	18.9
Accrued compensation	88.1	92.0
Restructuring liability	10.0	13.6
Accrued expenses and other current liabilities	213.8	191.1
Senior secured revolving credit facility	25.6	30.0
Long-term debt, current portion	97.1	83.1
Total current liabilities	740.9	724.4
LONG-TERM DEBT	2,753.7	2,730.7
PENSION AND RELATED LIABILITIES	378.0	361.6
DEFERRED INCOME TAXES	23.1	27.2
OTHER LIABILITIES	99.9	106.3
Total liabilities	3,995.6	3,950.2
MINORITY INTEREST	31.7	25.2
STOCKHOLDERS EQUITY:		
Common stock ($0.01 par value, 400,000 shares authorized, 73,875 shares issued and 73,781 shares outstanding at June 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	1,151.7	1,151.7
Accumulated other comprehensive income	158.9	52.0
Accumulated deficit	(290.5)	(367.6)
Treasury stock, at cost	(1.4)	(1.4)
Other	(0.2)	(0.7)
Total stockholders equity	1,019.2	834.7
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 5,046.5	$ 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)

	Six months ended June 30, 2006	2005 As restated See Note 16
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 77.1	$ 126.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	109.1	105.2
Deferred financing costs amortization	4.7	5.6
Foreign exchange gain, net	(2.9)	(114.0)
Non-cash interest expense on pay-in-kind loans		17.4
Loss on sale of business	11.3	
Gains related to asset sales	(0.6)	
Fair value adjustment of derivatives	(15.5)	(6.2)
Bad debt provision	0.2	0.8
Deferred income taxes	(4.7)	21.0
Minority interest	4.2	(1.7)
Changes in assets and liabilities, net of the effect of foreign currency translation and acquisitions:		
Accounts receivable	(49.0)	(28.8)
Inventories, including inventory write-up reversal	(15.1)	(24.3)
Prepaid expenses and other assets	6.9	(13.3)
Accounts payable	(24.5)	43.2
Income taxes payable	19.7	3.1
Accrued expenses and other liabilities	(15.4)	(56.4)
Net cash provided by operating activities	105.5	78.5
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired	(13.4)	
Capital expenditures, excluding capital leases	(90.1)	(92.4)
Proceeds on sale of property, plant and equipment	2.5	0.2
Net cash used in investing activities	(101.0)	(92.2)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from senior secured credit facilities	103.1	302.0
Repayment of senior secured credit facilities	(129.2)	(302.0)
Payments on other long-term debt	(40.6)	(15.6)
Net cash used in financing activities	(66.7)	(15.6)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(3.4)	(0.3)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(65.6)	(29.6)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	102.2	111.3
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 36.6	$ 81.7
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$ 86.5	$ 97.9
Income taxes paid, net of refunds	$ 6.4	$ 18.1
NON-CASH INVESTING ACTIVITIES:		
Acquisition of equipment under capital leases	$ 1.5	$ 4.8
Decrease in liabilities for property, plant and equipment	$ (15.5)	$ (15.6)

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.

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 (formerly known as Custom Synthesis), 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 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 In the ordinary course of business, Rockwood has engaged in transactions with certain related parties including KKR and DLJ Merchant Banking Partners III, L.P. (DLJMB) and affiliates of each. 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 other 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 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:

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Net income	$ 37.1	$ 88.6	$ 77.1	$ 126.9
Foreign currency translation	93.6	(79.4)	119.0	(119.9)
Intercompany foreign currency transactions	34.9	(96.7)	66.5	(161.8)
Net investment hedge, net of tax	(57.9)	25.0	(83.2)	31.2
Reduction of minimum pension liability, net of tax			4.6	
Total comprehensive income (loss)	$ 107.7	$ (62.5)	$ 184.0	$ (123.6)

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 June 30, 2006 and December 31, 2005. The Company does not expect any of the loss on the net investment hedge residing in other comprehensive income at June 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 $875.0 million based on the June 30, 2006 exchange rate of 1.00 = $1.2787). 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 June 30, 2006. The Company does not expect any of the loss on the net investment hedge residing in other comprehensive income at June 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. That cost will be 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, New Accounting Standard 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 effected 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 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 are 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 and is currently evaluating the impact it will have on its financial statements.

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.

2. NEW ACCOUNTING STANDARD 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 six months ended June 30, 2006, the adoption of SFAS No. 123R resulted in incremental stock-based compensation expense of less than $0.1 million and $0.1 million, respectively. The incremental stock-based compensation expense caused income before taxes and minority interest to decrease by less than $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 June 30, 2006. For the six months ended June 30, 2006, the incremental stock-based compensation expense caused income before taxes and minority interest to decrease by $0.1 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 June 30, 2005**	**Six months ended June 30, 2005**
Net income, as reported	$ 88.6	$ 126.9
Less: Stock-based employee compensation expense determined under fair value based method, net of tax	(0.2)	(0.4)
Pro forma net income	88.4	126.5
Redeemable convertible preferred stock dividends	(1.2)	(2.3)
Pro forma net income applicable to common shareholders	$ 87.2	$ 124.2
Earnings per common share, as reported:		
Basic	$ 1.74	$ 2.48
Diluted	$ 1.68	$ 2.41
Pro forma earnings per common share, as reported:		
Basic	$ 1.73	$ 2.47
Diluted	$ 1.68	$ 2.40

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.

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Stock Purchase Eligible employees and directors can purchase shares of the Company s common stock at prices as determined by its board of directors.

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 EBITDA.

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 the three and six months ended June 30, 2006 for share-based compensation programs was less than $0.1 million and $0.1 million, respectively, before taxes.

The fair value of options granted in the first six months of 2006 is estimated on the date of grant using the Black-Scholes option pricing model that used the assumptions noted in the following table:

Expected term (in years)	6.0	
Expected volatility	35	%
Risk-free rate	4.7	%
Expected dividends	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 June 30, 2006, there was $0.2 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 2.4 years.

As of January 1, 2006 and June 30, 2006, the number of nonvested stock options determined in accordance with SFAS No. 123R were 53,800 and 35,557, respectively, and the weighted-average grant date fair value of nonvested stock options were $8.68 and $8.75, respectively.

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

A summary of the status of the Company s options granted pursuant to the Plan at June 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	11	23.68		
Exercised	(2)	14.61		
Forfeited	(42)	18.76		
Outstanding at June 30, 2006	3,830	$ 14.67	6.70	$ 32.0
Options exercisable at June 30, 2006	1,695	$ 14.61	6.09	$ 14.2
Weighted-average fair value of options granted during the period	$ 10.12			

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 June 30, 2006.

The compensation cost charged against income under the Subsidiary Plan in the three and six months ended June 30, 2006 for share-based compensation programs was less than $0.1 million before taxes.

There were no options granted or exercised in the first six 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 June 30, 2006, there was 0.9 million ($1.2 million using a June 30, 2006 exchange rate of 1.00 = $1.2787) 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 3.3 years.

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A summary of the status of the options granted by Groupe Novasep at June 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	(1)	211.00		
Outstanding at June 30, 2006	21	211.00	9.33	
Options exercisable at June 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 June 30, 2006									
Net sales	$ 232.0	$ 212.8	$ 111.0	$ 98.0	$ 84.3	$ 66.1	$ 51.6	$	$ 855.8
Adjusted EBITDA	50.7	42.8	21.8	25.6	19.8	8.6	9.7	(12.8)	166.2
Three months ended June 30, 2005									
Net sales	$ 219.7	$ 190.1	$ 109.2	$ 96.4	$ 95.0	$ 62.1	$ 44.9	$	$ 817.4
Adjusted EBITDA	49.4	47.2	22.1	24.1	12.8	7.4	7.0	(9.5)	160.5
Six months ended June 30, 2006									
Net sales	$ 460.1	$ 395.3	$ 219.2	$ 190.7	$ 172.8	$ 129.3	$ 101.0	$	$ 1,668.4
Adjusted EBITDA	102.1	76.1	42.7	49.2	35.7	15.9	18.3	(25.1)	314.9
Six months ended June 30, 2005									
Net sales									