This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues
✓ **Fundamentals:** Analysis of fundamentals

Big Debt Load, Recession Risks and Insider Anomalies Celanese Corp. (NYSE:CE)

January 24, 2008

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Business Description

Celanese Corporation engages in the production and sale of industrial chemicals primarily in North America, Europe, and Asia. The Company had total sales of $6.399 billion to external customers in 2006 across four different market segments: Chemical Products (72.0% of 2006 sales), Technical Polymers Ticona (14.3%), Acetate Products (10.9%), and Performance Products (2.8%). The Company has substantial exposure to several highly cyclical markets and industries, including the automotive, electrical, construction and textile industries. In 2004, the Company was taken private by Blackstone Group, and then taken public again in an IPO in early 2005. The Company markets its products through its sales force and distributors, as well as through e-channels, including its Web site. Celanese was founded in 1912 and is headquartered in Dallas, Texas.

Key Statistics

Sector:	Last Close:	Market Cap:	Avg Vol (3m):
Basic Materials	**$34.45**	**$5.21B**	**1,711,980**
Industry:	**52 Wk Range:**	**Trailing P/E:**	**Shrs Out:**
Chemicals – Major Divs.	**$24.86-$44.77**	**20.53**	**151.22M**
F/T Employees:	**FYE:**	**Forward P/E:**	**Short % of Float:**
8,900	**31-Dec**	**9.41**	**2.10%**

Summary of 3DAdvisors Findings for CE

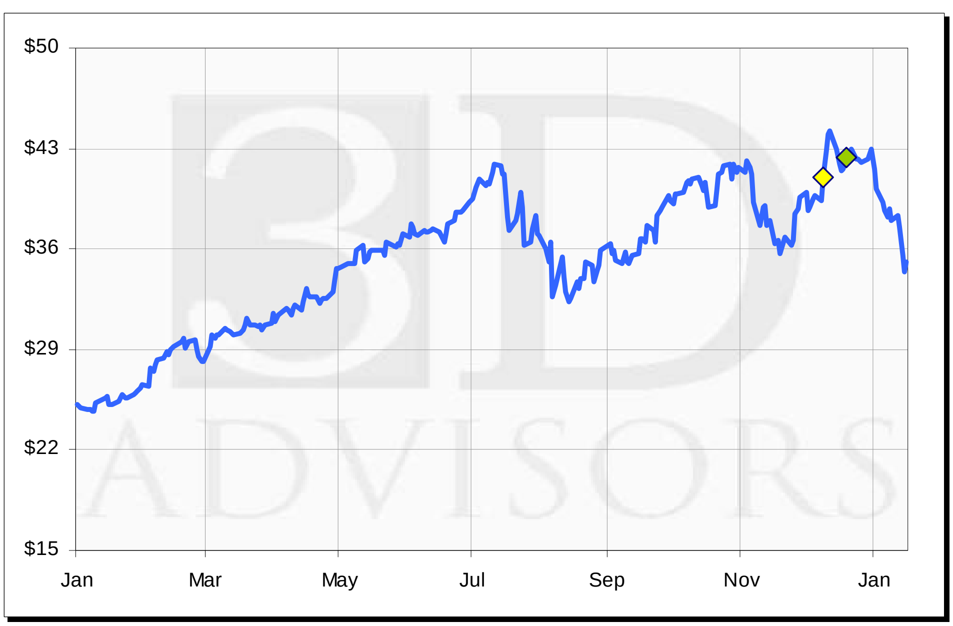
- **Fundamentals:** Company is left straddled with debt, more exposed to downturn
- **Insider Trading:** After raising guidance, insiders sell aggressively into rally
- **Governance:** Abrupt and unusual departure by head of second largest division
- **Fundamentals:** Downplaying commodity price and other risks?
- **Accounting:** Miscellaneous noteworthy items

Discussion of 3DAdvisors Findings for CE

It seems to us that the recent anomalous insider trading behavior at Celanese may be telegraphing that rising recession risks, combined with a heavy debt load, may provide a downside catalyst for CE shares in the near future. This in spite of the groundswell of analyst upgrades following the Company's presentation on December 11th of a very bullish outlook and guidance hike for 2007. The upbeat presentation by senior management clearly relieved some of those who have been concerned about the Company's exposure to recessionary pressures, as the shares went on to rally 15% on the news. Then, one week later, Celanese announced in a press release that S&P had raised the Company's rating on its outstanding debt from BB- to BB with a positive outlook, providing even more support for the shares.

Although management's bullish outlook in the face of increasing recession concerns and the upgrading of the Company's debt seemed to assuage any related fears on the part of investors, certain Celanese insiders behaved in a curiously contrary fashion with two selling on the day of the guidance hike under 10b5-1 plans filed earlier in the quarter. Separately, a big sale by the Company's newly-appointed CFO took his holdings down by 95% -- a trade that violated the short-swing rule as he had been a buyer of shares less than six months prior – and underscored the disconnect between what management was saying with what they were doing. And though management may well have the ability to meet or beat expectations for Q407 (to be announced 02/05/08), we think CE could be an interesting recession play. The shares have been beaten back down recently as fears of recession have spread beyond the U.S. and market volatility has increased substantially, but any near-term rally in the shares could provide a good entry point as we believe 2008 could be a more challenging year for the Company than many suspect.

Figure 1. CE Daily Closing Price, 01/03/07 and 01/22/08. Yellow diamond is the date CE provided bullish outlook and raised 2007 guidance (12/11/07); Green diamond is the date CE announced the upgrade by S&P (12/18/07). Source: Reuters and CE.



Fundamentals: Company is left straddled with debt, more exposed to downturn

Count Celanese among the group of companies that have been taken public by private equity firms who have subsequently dumped their stakes after having paid themselves handsomely, leaving behind a substantially weakened Company straddled with significant debt. Clients may recall that we highlighted a similar situation at Knoll Inc. (NYSE:KNL) in a 3DA Full Report (05/11/07). Much like Celanese now, we had found Knoll shares holding up at the same time the Company faced a challenging business environment. As with Celanese now, Knoll insider behavior was telling in that it contrasted with very positive management-speak at the time. KNL shares have since dropped 50% from the time of our May report, a fact which has sharpened our focus on the parallels that exist at Celanese.

Blackstone, who took CE public for a second time in 2005, is now completely out of its Celanese position, having cashed out its last 22.1 million shares back in May of 2007. In the two years after Blackstone brought Celanese pubic, reaping an $804 million dividend in the process, the firm has raised an additional $2.3 billion by cashing out its entire position. This final exit act of the Blackstone/Celanese era triggered additional long-term compensation payouts totaling another $75 million to members of Celanese management who had been enticed to stay on watch while Blackstone remained an investor. So Blackstone has exited with over $3 billion in its coffers, leaving the new shareholders straddled with $3.3 billion in long-term debt or, better stated, almost five times Shareholders' Equity. Additionally, in all but one quarter since Q205, cash on hand in any period has been less than trade payables.

In the third quarter alone (period ended 09/30/07) interest expense was $63 million, or 43% of the Company's operating profit. This was after a significant debt restructuring in Q2 which cost Celanese $256 million in redemption premiums. For the nine months, interest expense consumed 46% of operating profits. The burden of interest expense did not stop the Celanese board from authorizing an aggressive series of share repurchases, however, as the Company paid out $403 million during the first three quarters carrying out such initiatives.

It is quite clear that the Company's significant indebtedness, largely taken on for the benefit of Blackstone as a well-compensated and compliant management stood by and watched, represents significant risks should business conditions deteriorate and cash flow weaken. The following comes from the risk section of the Company's 2006 SEC Form 10-K:

> ***Our high level of indebtedness could diminish our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or the chemicals industry and prevent us from meeting obligations under our indebtedness.***
>
> We are highly leveraged. Our total indebtedness is approximately $3.5 billion as of December 31, 2006 (excluding $134 million of future accretion on the senior discount notes).
>
> Our substantial debt could have important consequences, including:

- making it more difficult for us to make payments on our debt;

- increasing vulnerability to general economic and industry conditions;

- requiring a substantial portion of cash flow from operations to be dedicated to the payment of principal and interest on indebtedness, therefore reducing our ability to use our cash flow to fund operations, capital expenditures and future business opportunities;

- exposing us to the risk of increased interest rates as certain of our borrowings, primarily the borrowings under the amended and restated senior credit facilities, are at variable rates of interest;

- limiting our ability to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, acquisitions and general corporate or other purposes; and,

- limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who have less debt.

Though Celanese shares received some juice from the December S&P upgrade, we also note a contrary, and potentially ominous, warning from Moody's which states that the rating agency would consider a private equity penalty to be applied to acquired companies which have been straddled with significant long-term debt after having paid large dividends to the acquirers. Now that Celanese has been kicked out of the Blackstone nest, with its baggage, it will be interesting to see how the Company is able handle its high level of debt service should a recession materialize, especially if that recession extends beyond the U.S.

<u>Insider Trading: After raising guidance, insiders sell aggressively into rally</u>

Celanese, like many companies, is quite the press-release machine. Seldom is an opportunity missed to float out positive news. We have always had a great interest in situations where companies issue positive releases, such as strategically timed guidance hikes, followed by key members of management selling into the news. This is just what we have seen here, but to a much more dramatic extent. Celanese shares rallied on December 11th when, during its 2007 Investors' Day Conference, management hiked guidance for FY 2007 to $3.26 to $3.31/share (consensus was $3.21) while leaving 2008 in-line with the Street.

We note that four of the presenters in that bullish conference sold on the rally they played such key roles in sparking. Three of them sold on the following day, two under the cover of 10b5-1 plans, selling a total of 356,900 Celanese shares at prices between $42 and $43, right on the highs. The fourth presenter, CFO **Steve Sterin**, had to wait until his options vested in early January, at which point he wasted no time dumping a significant percentage of his shares, and in so doing violated the short-swing rule (more on this later). Aside from CEO **David Weidman**, the only other presenter that did not sell in the ensuing rally was the newly appointed head of the Company's Ticona division (more on this later), **Sandra Lin**, who has nothing to sell as her first options will not vest until January of 2009. Seldom do we see such collective, aggressive action from a management team taking advantage of a short-term, self-induced rally the likes of which occurred on December 11th.

Clearly, Celanese insiders had been blocked out from selling for a period after Blackstone's final secondary in May. However, the window had opened in July and, although there had been selling in August through November (four sold 473,000 shares), the one-day post guidance total is clearly an event that raised our eyebrows, especially given the fact that two of the sellers had entered into 10b5 plans earlier (between late September and mid November) but both waited to commence their plan sales until the day after the guidance hike, and right on the highs at that.

Here are the trading details for members of the management team who were in involved in the December 11th Investors' Day Conference:

- **Steve Sterin (35)** – CFO. The initial sales on the guidance grabbed us first but our attention became more riveted when newly-appointed CFO, Steven Sterin **dropped 95% of his position (actionable options and common)** in January with his sale of 25,000 shares. Though the amount may not seem large, Sterin, at just 35, has not had a lot of time to build a position. His decision to clear out what he had at his earliest opportunity was not lost on us. He was named to his position this past July when then-CFO **John Gallagher** moved over to the position of President of Acetyls and Celanese Asia, a pivotal segment which had just suffered the loss of its head due to medical issues. Sterin was moved up from corporate controller in the process. In order to sell the shares, Sterin exercised options for 25,000 shares immediately upon their vesting. The options did not expire until 2016. An interesting side-bar to Sterin's activity is the fact that, in his apparent haste to sell, he violated the short-swing profit rule (Rule 16b-3) as he had purchased 1,500 shares in the open market back on August 13th. So, within six months of that time he has sold shares and will, more than likely, have to disgorge the profits on the 1,500 shares. He largely depleted his actionable position with his sale, as he has few shares of common and will see no new options vest until 37,500 do so in January of 2009 (see Appendix A).

- **John Gallagher (43) –** President, Acetyl Intermediate and Celanese Asia. Gallagher had filed a 10b5-1 back on September 26th but had not acted under the program until the December 11th news of the Company's guidance hike. He responded by exercising options for 200,000 shares which he immediately sold at $43. **His sale trimmed his holdings by 35%.** We had previously noted his reduction at 60% (Research Notes 01/11/08) but have since found additional information which clarified his holdings picture. Gallagher's options were not set to expire until August of 2015. His next series of options to vest will total 167,900 shares but will not vest until December of 2008 (see Appendix A). The sales are his first on record.

- **Doug Madden (55) –** President, Celanese Acetate. Madden has served as President of Celanese Acetate since September of 2003. As did Gallagher, Madden filed an earlier 10b5-1 plan (on November 13th) but had withheld from selling until the day after the December 11th guidance hike. He responded to the news by exercising options for 100,000 shares which he unloaded at $43. His options were not set to expire until January of 2015. Before filing his 10b5-1 Madden had sold 51,000 shares earlier in September. In total, he has **reduced his exposure to Celanese**

stock and options by 52% and will not gain access to additional shares until December 2008 when 61,555 options vest (see Appendix A).

- **James Alder (age not disclosed) –** Senior V.P., Operations and Technical. Alder is the primary driver behind the start-up of the Company's Acetyl Acid facility and current expansion, and integration, of other processing at its key Nanjing, China Acetyl complex. This high-priority project is expected to be a low-cost, integrated Acetyl/chemical complex that is pivotal to the Company's plans for expanding its presence in the Asian markets. Though he, like the others, showed nothing but unabashed confidence in his presentation at the Investors' Day Conference, his actions spoke otherwise as he sold 54,900 shares, exercising options not expiring until January 2015 in the process. Alder had been selling since mid-September and has, to date, **cleared out of 187,000 shares, or 65% of his actionable holdings**. He will not see new options vest until 78,211 do so in December of 2008 (see Appendix A).

To these, we must remind clients of the September/October selling by General Counsel **Curtis Shaw** and SVP, Strategy & Development, **Jay Townsend** who dropped 27% and 46% of their holdings, respectively, during the period. Please be advised that both of these individuals were reported as having sold higher percentages in our January 11th report but due to additional information we have discovered we have lowered the percentage reductions.

<u>Governance: Abrupt and unusual departure by head of second largest division</u>

Above we mentioned the fact that Sandra Lin, the new head of the Company's Technical Polymers/Ticona division, the second largest of four segments which had sales of $915 million in 2006 or over 14% of total net sales for the Company, had not sold any shares as she has none to sell since none of her options has vested. But we did note one very curious governance item in connection with Ms. Lin's predecessor. She replaced **Dr. Lyndon Cole** (55) who retired this past July and agreed to stay on until December 31st to aid in the transition. Cole, previously one of the five named officers at the Company, joined CE in 2002 having formerly been the CEO at UK-based Elementis PLC, a global specialty chemicals company. Though few details are available concerning his departure, we note that the timing of his departure is highly unusual in that he has forfeited one of the largest set of awards we have seen in quite some time. Cole forfeited options that were scheduled to vest in 2008 and 2009 that were in-the-money to the tune of $8.1 million (before taxes). He also forfeited Long Term Deferred Compensation in the approximate amount of $3.3 million. His 2006 salary and bonus weighed in at $1.7 million. We have nothing to conclude from this information other than the fact that it is a highly unusual governance behavior under almost any circumstance and we wonder what would have caused him to act in such a precipitous fashion.

<u>Fundamentals: Downplaying commodity price and other risks?</u>

Even by management's admission, Celanese faces commodity price pressures in a number of its key raw materials used for manufacturing, not the least of which are Methanol and Ethylene. Higher prices for these two production inputs actually help the Acetyl Intermediates business but negatively affect the Industrials Specialties businesses. From CEO David Weidman's prepared statement during the Q307 conference call [bolding is ours]:

> **Our downstream Industrial Specialties businesses were significantly impacted due to both raw material volume constraints and higher raw material costs during the quarter. While this environment has a positive earnings effect on Acetyl Intermediates' business, as we expected it will challenge our downstream Industrial Specialties businesses, which consume final acetate and whose pricing tends to be a bit stickier than other businesses. It is unlikely that these businesses will be able to offset the lost volume or margin by the end of the year.**

To wit, the Company concedes that its Industrial Specialties businesses will be "challenged" beginning in 2008 with higher input costs. When it comes to guidance, however, it seems that the volatility of certain commodity prices has been assumed away in Management's model. This exchange took place during the Q3 conference call question and answer session:

> **Analyst:** David, you have in the past shown your resilience to higher methanol prices. Given the latest methanol price spike, what is your expectation for Q4 with the impact from higher methanol prices?
>
> **Dave Weidman, CEO:** There is really no change. The model that we have in place does mitigate the impact of methanol volatility, methanol down, methanol up. We tend to be hedged very well across the globe. We may see earnings shifting from one business to another business or one region of the world to another region of the world. As an example, we would expect in the fourth quarter that we would probably see some higher pricing of methanol in Asia, impinging on margins over there; North America would be advantageous to us. Ticona would be under a little bit of a pressure. So it will shift a little bit, but overall these levels of pricing don't concern us.

Currently, the Industrial Specialties business accounts for about 20% of the Company's sales but does not generate profit. Weidman is quick to assume that this will turn around once pricing pressures ease in the Acetyl Intermediaries business but correspondingly, pricing power at Acetyl Intermediates is expected to fall. From the Q3 conference call [bolding is ours]:

> **Clearly our 2007 earnings are benefiting from strong pricing environment in our Acetyl Intermediates business; however, we continue to expect pricing trends to ease and move back into more historic levels throughout 2008. Our key raw material inputs, methanol and ethylene, continue to be volatile and historically high. As we have demonstrated over the past several quarters though, our business model has the ability to mitigate this volatility fairly well. And we expect this to continue.**

Excuse us, but especially these days, the assumption of being perfectly hedged seems to be a risky one at best. The Company displays a reasonable level of transparency concerning risks, both present and potential. However, at the same time the Company may be overly optimistic as to the likelihood of occurrence of various potential risks and less than conservative in making provisions for such occurrences.

Areas of concern may include guarantees for businesses sold ($2.3 billion), various guarantees arising out of merger and restructuring activities, environmental liabilities, and pending litigation. Possible hits from goodwill and intangibles impairment (non cash, albeit dilutive to GAAP EPS) also loom as potential negatives.

Accounting: Miscellaneous noteworthy items

- **$200 million in debt principal payments were due in Q407:** Celanese faced a principal payment of $198 million in Q4. Given its $531 million cash position at 09/30/07 and the high current payable balance of $675 million at that same time, the large Q4 payment most definitely was a significant item. Payables have been straight-lining for 12 consecutive quarters averaging $735 million per period.

- **Certain share repurchases made from Blackstone funds:** As mentioned above, in spite of the Company's highly leveraged position, the Celanese board approved a repurchase of $62 million in a Dutch Auction tender offer in April, prior to Blackstone's final exit. The Company subsequently repurchased $10 million in shares from "investment funds associated with The Blackstone Group L.P." The exact dates of these repurchases have not been disclosed. In addition, in June the CE board approved another repurchase, this time for up to $330 million in shares. By the end of July, this repurchase had been consummated, bringing the total amount of shares bought by the company for the nine month period to $403 million.

- **Exposure to auto industry:** It is no secret that Celanese has considerable exposure to the automotive industry, but the exact extent of exposure to the highly cyclical industry is not disclosed. Highlighting this risk is the fact that Toyota is the Company's largest customer, globally. Though this fact is not disclosed in Company financials it was revealed in the Q3 conference call.

Appendix A

Option and Restricted Stock Vesting Schedules for Selected Celanese Corp. Insiders

Grant Date	Equity Type	Options/ Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
James Alder, Senior V.P. of Operations and Technical. Common stock holdings: 76,941 shares								
01/21/05	Options	391,055	$16.00	01/21/05	01/21/15	133,655	97,764	78,211 vest on 12/31/08, 19,553 vest on 03/31/09
John Gallagher III, Executive V.P., President of Acetyls and Celanese Asia. Common stock holdings: 37,000 shares								
08/31/05	Options	292,000	$18.30	12/31/05	08/31/15	192,000	73,000	58,400 vest on 12/21/08, 14,600 vest on 03/31/09
08/31/05	Options	438,000	$18.30	12/31/05	08/31/15	338,000	109,500	12/31/08
07/25/07	Options	120,000	$40.13	01/01/09	07/25/17	120,000	120,000	01/01/09, 01/01/10, 01/01/11, 01/01/12
Doug Madden, President of Acetate. Common stock holdings: 60,556 shares								
01/21/05	Options	307,775	$16.00	01/21/05	01/21/15	156,775	76,944	61,555 vest on 12/31/08, 15,389 vest on 3/31/09
Curtis Shaw, Executive V.P., General Counsel, Secretary. Common stock holdings: 27,100 shares								
04/18/05	Options	74,000	$15.16	12/31/05	04/18/15	74,000	29,600	12/31/08, 12/31/09
04/18/05	Options	111,000	$15.16	12/31/05	04/18/15	74,000	27,750	12/31/08
10/10/05	Options	126,000	$16.82	12/31/05	10/10/15	113,000	50,400	12/31/08, 03/31/09
10/10/05	Options	189,000	$16.82	12/31/05	10/10/15	139,000	47,250	12/31/08
Steven Sterin, Senior V.P., Chief Financial Officer. Common stock holdings: 1,500 shares								
05/16/06	Options	40,000	$21.02	01/01/08	05/16/16	30,000	30,000	01/01/09, 01/01/10, 01/01/11
06/30/06	Options	60,000	$20.37	01/01/08	06/30/16	45,000	45,000	01/01/09, 01/01/10, 01/01/11
07/25/07	Options	50,000	$40.13	01/01/09	07/25/17	50,000	50,000	01/01/09, 01/01/10, 01/01/11, 01/01/12
Jay Townsend, Senior V.P. of Business Strategy and Development. Common stock holdings: 85,490 shares								
01/20/05	Options	434,506	$16.00	01/20/05	01/20/15	244,506	108,627	86,901 vest on 12/31/08, 21,726 vest on 03/31/09