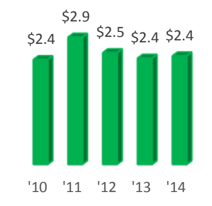
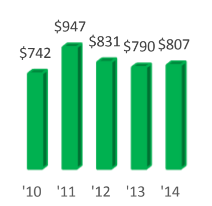
Albemarle Corporation
August 27, 2015

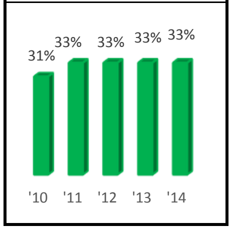
General Overview

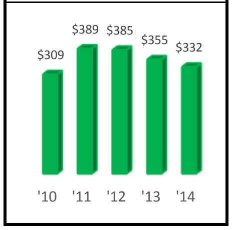
Albemarle (ALB) manufactures highly-engineered specialty chemicals to meet customer needs across a wide range of industries. The company's products are key inputs for efficient petroleum refining, heat resistant consumer electronics, high quality construction materials, vital crop protection, and much more. Products are sold to more than 2,500 customers in approximately 100 countries. As a global leader in specialty chemical manufacturing the company is perfectly positioned in the value chain to deliver strong results for shareholders for decades to come.

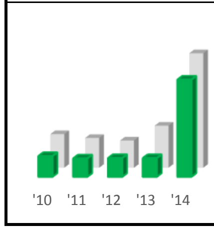
Revenue	Gross Profit	Gross Profit Margin	Owner Earnings	Balance Sheet
$2,445,548,000	$807,030,840	33%	$331,981,500	Cash = $2.4B
5-Year CAGR = 0.9%	5-Year CAGR = 2.1%	5-Year AVG = 33%	5-Year CAGR = 1.8%	Debt = $2.9B











Purchase Logic

Our purchase of ALB remains consistent with our commitment to remain defensive in this difficult investment environment. Despite the 10% decline in the S&P 500 during the most recent month the majority of outstanding businesses remain relatively expensive compared to historical averages – which is rational given the low interest rate environment. As a business ALB passes our selective process, demonstrating consistent earning power between $300 million and $400 million per year. After the acquisition of Rockwood Holdings that was completed in January this year - the combined entity now employs 7,000 highly talented individuals that serve more than 2,500 customers in over 100 countries. The three primary divisions for the business are: Performance Chemicals, Refining Solutions, and Chemetall Surface Treatment. The customer base is diverse with no single product line contributing uniquely to revenue or profit – bringing safety through diversification.

Historically the company operated with a very moderate level of debt, but recently assumed an additional $3 billion in financing to acquire Rockwood Holdings. The one-time costs associated with the acquisition will depress earnings during 2015 due to roughly $190 million in various charges related to the merger – including restructuring charges, legal fees, inventory adjustments, and amortization of intangibles. After adjusting for these one-time items it is apparent that ALB will possess earning power in excess of $500 million in 2016 and beyond. When we bought our stake in the company the market capitalization was just below $5 billion dollars – or 10x our projected 2016 earnings. This is a very favorable purchase price for the world's premier specialty chemical manufacturer and a wonderful opportunity for long-term investors.

Key Metrics

The key metrics for the business are revenue, gross profits, gross profit margin, owner earnings, and interest coverage. The business drivers that influence each metric are described in more detail below.

Revenue

Revenue is generated through the sale of specialty chemicals to more than 2,500 customers. These customers include drilling and oil service companies, automobile companies, food processing companies, beef and poultry processors, water treatment and photographic companies, and energy producers. While the customer base is widely diversified the revenue for the business is still impacted by the business cycle of certain industries. For example, when the demand for automobiles declines the specialty chemicals sold to auto manufacturers declines. The industries served by ALB, while all unique, often simultaneously see economic downturns. This causes ALB's revenue to fluctuate based on economic conditions, but the diverse group of customers brings some stability to earnings and safety in the long-term economics of the business.

Gross Profits

The gross profits are calculated by subtracting the cost of raw materials, such as bromine or lithium, from the sale price of each chemical product. The input costs for manufacturing each product type is variable, meaning that as revenue increases so does the cost of goods sold. Due to the strong pricing power of ALB (discussed further below) the gross profits tend to move proportionally with revenue.

Gross Profit Margin

For the majority of industries the gross profit margin is an indicator of pricing power (or lack thereof). Typically, as the price of raw inputs increase the gross profit margin would contract, because the majority of businesses are unable to pass the price increases on to customers. This is especially true for businesses that make products that are undifferentiated. ALB's specialty chemicals are of sufficient quality, importance, and technical complexity that competitors cannot easily mimic the various product lines. This is evident in ALB's ability to pass fluctuating input costs onto customers and maintain stable gross margins. This is a testimony to company's leadership, outstanding R&D programs, and the talented individuals that work for ALB.

Owner Earnings

The owner earnings for the business is a measure of the cash generated by the business that would be available to distribute to the owners each year – without sacrificing the competitive position of the business. In the case of ALB the depreciation expense is very real and is not added back to net income, but certain intangibles (customer relationships, trademarks, discontinued operations, manufacturing contracts and supply/service agreements) and the one-time expenses related to the acquisition of Rockwood Holdings in 2015 were added back to project the 2016 owner earnings.

Interest Coverage

The interest coverage is calculated as operating earnings divided by the interest expense. This figure is critical in determining if the level of debt assumed by the business is prudent. We define operating earnings as the GAAP reported figure plus certain one-time charges, such as restricting expenses, or the annual amortization of intangibles. The deprecation charge is not added back in (traditional EBITDA) because these capital outlays are required annually to maintain the company's competitive position.

$$Interest\ Coverage = \frac{Operating\ Earnings}{Interest\ Expense}$$

Operating Earnings: GAAP reported operating earnings plus one-time charges and certain non-cash amortization expenses.

Historical Performance of Key Metrics

Year	'10	'11	'12	'13	'14
Total Revenue	$2,362,764,000	$2,869,005,000	$2,519,154,000	$2,394,270,000	$2,445,548,000
Gross Profit	$741,910,000	$946,771,650	$831,320,820	$790,109,100	$807,030,840
Gross Profit Margin	31%	33%	33%	33%	33%
Owner Earnings	$308,766,750	$388,613,250	$384,522,750	$355,021,500	$331,981,500
Interest Coverage	-	-	-	76	30
Cash	$529,650,000	$469,416,000	$477,696,000	$477,239,000	$2,489,768,000
Debt	$860,910,000	$763,673,000	$699,288,000	$1,078,864,000	$2,934,131,000

Revenue

In the last 5 years ALB has not experienced material revenue growth, but has been relatively stable between $2.3 billion and $2.8 billion. The fluctuations in revenue are largely tied to the business cycle of ALB's customers and is not representative of changes in market share in the specialty chemical space. For this reason we like ALB as a mature business and the recent acquisition of Rockwood Holdings should increase revenue to nearly $4 billion. It is our expectation that revenue would fluctuate as much as +/- 20% per year, but maintain an average of roughly $4 billion for the next 10 years.

Gross Profits

Gross profits have fluctuated in line with revenue due to the outstanding pricing power of ALB's products. It is our expectation that gross profits would be roughly $1 billion or more in the next 10 years and would fluctuate in-line with revenue.

Gross Profit Margin

The gross profit margin has been stable at 33% for the last 5 years. The recent acquisition adds several new product lines to the combined business and the gross profit margin will shift to match the margin profiles of the combined entities. It is our expectation that the new gross profit margin profile of the combined businesses would remain stable – fluctuating less than +/- 5% year over year while maintaining long-term averages.

Owner Earnings

The owner earnings of the business fluctuated between $300 million and $400 million in the last 5 years, but the acquisition of Rockwood Holdings should increase earnings to more than $500 million per year. It is our expectation that these earnings will be allocated to dividends (3% yield) and debt reduction in the upcoming years.

Interest Coverage

At our time of purchase ALB had cash of $207 million and debt of approximately $4 billion. The current level of debt is historically very high for the business and it is our expectation that management will pay this down rapidly in the upcoming years. The company currently generates roughly $800 million in operating profit before taxes and interest compared to interest payments of roughly $140 million per year. This represents an interest coverage of just over 5.5x.

Summary of Key Metrics

Metric	Expectations
Revenue	Fluctuating between $3.2 billion and $5 billion
Gross Profit	Fluctuating in-line with Revenue
Gross Profit Margin	Stable between 30% and 35%
Owner Earnings	Fluctuating between $350 million and $700 million Average of $550 million over next 10 years
Debt	Reduced by roughly $300 million per year for the next 3 years Interest Coverage of more than 6x

The Moat Around The Metrics

The future profits of ALB are protected through a wide and sustainable moat that centers on the company's expertise in synthesizing performance chemicals. Unlike commodity type chemicals, ALB's products are used by customers based on performance and function. These chemicals are unique formulations that add tremendous value for customers and are difficult for competitors to emulate on a large manufactured basis. The chemicals influence the performance of the customer's end product – hence the willingness to pay premium prices for quality. This pricing power is evident in the company's ability to pass on price fluctuates to customers and maintain a stable gross profit margin. The position as a global leader in a variety of niche categories is a competitive advantage that will endure into the future.

Risks

As a global operator ALB is regulated in numerous regions around the world for a wide variety of products. The largest risks we face as owners likely stem from five sources: Regulation, Accidents / Remediation, Cyclical Downturns, and Natural Disasters. In aggregate we view the total risk as owners of ALB has very low.

Regulation – ALB is heavily regulated in more than 100 countries for each type of specialty chemical manufactured by the company. From time to time products currently in use can be banned from certain regions of the globe. Today there is increased scrutiny for brominated flame retardants – which makes up a healthy portion of ALB's revenue and profits. We view the regulatory risk as remote due to the incredibly diverse product base and geographic regions in which ALB operates.

Accidents / Remediation

When chemical accidents occur the company is typically liable for remediation costs associated with the accident. While safety and perfection is the goal – it is very likely that ALB will experience some type of chemical accident in the ensuing decade. The size and scale of operations is too large to expect perfection in an uncertain world. While these accidents and the associated remediation charges will be expensive – we view these risks as acceptable as owners of the business. In the event there is a substantial accident it is possible there would be a sharp downward decline in the price of the stock. We would view this price decline as temporary in nature.

Cyclical Downturns

ALB's customers operate in businesses that are cyclical in nature. In the event that the economic conditions of the customer base deteriorate it would have a meaningful impact on ALB. This risk is certain to be realized from time to time and an acceptable reality for the owners of ALB. We make no attempt to predict when the downturns will occur.

Natural Disasters

A large portion of ALB's customer base is in the oil and gas refining business with substantial operations near the Gulf of Mexico in the United States. In the event there is unusual hurricane activity it will have a material impact on ALB's customer base and reduce the demand for ALB's products. This risk is certain to be realized from time to time and an acceptable reality for the owners of ALB. We make no attempt to predict when the downturns will occur.

Conclusion

Albemarle (ALB) manufactures highly-engineered specialty chemicals to meet customer needs across a wide range of industries. Products are sold to more than 2,500 customers in approximately 100 countries demonstrating a diverse revenue stream with little concentration risk. Unlike commodity type chemicals, ALB's products are used by customers based on performance and function. These chemicals are unique formulations that add tremendous value and are difficult for competitors to emulate on a large manufactured basis providing a wide economic moat around the business.

Our purchase of ALB remains consistent with our commitment to remain defensive in this difficult investment environment. After adjusting for one-time items we believe that ALB will possess earning power in excess of $500 million in 2016 and beyond which translates to a price of roughly 10x 2016 earnings.

Works Cited

1) *ALB Annual Report - SEC Filing 10-K.* EDGAR, 2014

Disclaimer