

## Chairman's letter to shareholders

**As highlighted in my letter to you last year, AECI has embarked on a number of strategic initiatives. As a result of these, the Group will enhance its core businesses' future as providers of world class mining solutions and specialty chemicals to the mining and manufacturing sectors in South Africa, Africa and in other territories.**

For these strategic initiatives to succeed and to deliver on the Group's growth prospects, significant capital expansion and efficiency improvement projects are in progress.

The Company's total capital investment was R1 044 million in 2008. The projects progressed well in the year, notwithstanding delays and cost escalations in some instances. The benefits of the investments will begin accruing to AECI from 2009, and more markedly from 2010. More detail on major projects is given later in this letter.

2008 was, of course, a particularly eventful year in the global economic arena. Apart from the credit crisis, some unprecedented peaks and fluctuations in commodity prices were experienced as were extreme shifts in the demand/supply balance. In view of the effect of high commodity prices on working capital requirements, and the Company's extensive capital expenditure programme, the Board and management deemed it prudent to negotiate additional term debt with various local financial institutions. The debt was arranged on favourable terms.

### Trading performance

It gives me great pleasure to report that AECI as a whole delivered outstanding trading results in 2008. The Group's revenue from continuing operations increased by 48 per cent to R12 876 million and trading profit, before losses from the Pension Fund employer surplus and plan assets for post-retirement liabilities, was 39 per cent higher than in 2007 at R1 035 million.

It is also pleasing that margins remained more or less constant across the board and all the trading businesses managed commodity price volatility successfully.

Chemical Services Limited (Chemserve) was the star performer again, with revenue escalating by an impressive 50 per cent to R8 434 million and trading profit by 49 per cent to R851 million. Much of this increase is attributable to strong performances in Chemserve's mining-related businesses, including Chemical Initiatives, Industrial Oleochemical Products, Lake International and Senmin. The consumer-based businesses recorded mixed results, but were well managed and improved their margins.

Much of the capital programme that AECI embarked on in 2007 is focused on Chemserve's mining thrust and these projects are well on track. The guar plant and one of the two xanthate reactors, at Senmin in Sasolburg, were commissioned in the latter part of the year. The remaining projects will be commissioned during 2009. Although costs on certain of the projects have increased due to scope changes and foreign exchange rate increases, the projects are still expected to deliver acceptable returns.

Chemserve will focus on project delivery and working capital control in 2009, while continuing to explore acquisition opportunities.

AEL also had a good year, with revenue growth of 51 per cent to R4 079 million and a 52 per cent improvement in trading profit to R248 million. Contributors to this good performance were growth in the Surface and Massive business in South Africa and the mining boom in the rest of Africa. Trading profit growth was offset by the Narrow Reef business in South Africa where volumes remained under pressure owing to power shortages and safety-related issues. AEL also had to contend with a spike in the ammonia price, the worst such occurrence in 10 years.

Despite price movement in the market, AEL's operating margins remained constant at 6 per cent.

The Initiating Systems Automated Plant (ISAP) project is AEL's R620 million investment in a modern, high volume, high quality shocktube plant considered to be the "factory of the future". This project commenced in 2006 and is on track to be completed in 2010.

The first phase of the project has been completed and is operating to expectation. ISAP will position AEL as a hi-tech and safety-focused world class supplier of initiating systems and enhanced explosives.

Heartland Properties and Heartland Leasing manage the Group's property portfolio. Land sales declined by 4 per cent on the prior year. Revenue totalled R432 million, while trading profit contributed R45 million (R75 million in 2007) after R91 million (R83 million in 2007) of remediation expenses.

During the year, AECI's land holdings at Modderfontein and Somerset West were valued at R2 500 million by external professionals. It remains the Board's view that more value can be extracted from the property portfolio if it continues to be held and managed in the medium term. Depending on market conditions, the property business intends investing about R900 million over the next five years, at Modderfontein and Somerset West, to release more than 1 000 hectares of land to the market.

Owing to external factors, the property market in South Africa is currently depressed and Heartland does not anticipate significant sales over the next year to 18 months. During this lean period, the business will prepare land to ensure that it is optimally placed when market conditions improve.



## Chairman's letter to shareholders (continued)

### Portfolio

In accordance with authorisation received at the annual general meeting of the shareholders of AECI in May 2008, the Company repurchased a further 3 per cent of its own share capital in the year. As a consequence, AECI now holds 10 per cent of its share capital as treasury shares.

In the latter part of the year, AECI announced that it had, with great regret, decided to shut down the SANS Fibres (SANS) operations at Bellville, in the Western Cape. Over a protracted period, several unsuccessful attempts were made to dispose of the industrial nylon fibre and polyethylene terephthalate businesses as going concerns.

These businesses have been under significant pressure to deliver sustainable financial performances for the past few years. A number of factors including technology improvements in the Far East, high raw material prices that could not be recovered in the market, and excess global capacity did not make the businesses feasible without further large capital investment. It is most regrettable that 640 of our dedicated employees, some of them with many years of service, will be affected by the closure of operations at Bellville at the end of March 2009.

It is a tribute to the management and all employees at SANS that the business, which is accounted for as a discontinued operation, produced outstanding results for the year under very difficult circumstances. Trading profit before closure costs increased to R155 million (R19 million in 2007). This good performance is primarily attributable to the weakening of the rand in the year and high demand for fibre, post the closure announcement in November.

SANS's operation at Stoneville, in the USA, will continue to operate for the foreseeable future. This business is performing well and is self-sustainable. For the year SANS Technical Fibres, USA, delivered a trading profit of R49 million compared to a loss of R10 million in 2007. Certain strategic plant and equipment will be transferred from Bellville to Stoneville and this should enhance the operation's global footprint.

### Progress on investing in growth

Delivery in terms of a strategy formulated in 2007 was the key theme in the year under review. The Group has moved towards strengthening its position as a world class supplier to the mining sector in particular, not only on the African continent but also in other countries around the globe. The six projects related to this are well on track to deliver in 2009 and 2010. They include AEL's ISAP project and five investments in Chemserve: acrylamide and polyacrylamide plants at Senmin, Sasolburg; a CS<sub>2</sub> plant and two xanthate reactors, also at Senmin; a sulphonation plant at Akulu Marchon, Gauteng; and an oleochemical plant at the Resitec joint venture in Brazil.

The progress of these investments will remain management's key focus for 2009. Their implementation and delivery, within the approved capital spend, will ensure optimal financial returns for several years to come.

It is intended that, during 2009, a Broad-Based Black Economic Empowerment (BBBEE) transaction will be effected in the form of an employee and a community share trust. Our shareholders will be asked for their approval prior to the transaction. The Company already has BBBEE structures in place at AEL and at Chemserve's ImproChem. Across the Group, management will also focus on other areas of the BBBEE scorecard to improve current ratings in the year ahead.

### Directorate

In the 2008 financial year a number of changes to the Board took place. Schalk Engelbrecht retired in March after five years as chief executive and 28 years with the Group. He remains on the Board as a non-executive director.

Schalk was succeeded as chief executive by Graham Edwards, with effect from 1 March. Graham has been with the Group for 30 years and had been managing director of AEL since 1999. He was appointed an executive director to the Board in 2007.

In August, we regrettably said farewell to Roger Williams, who emigrated to the United Kingdom as a direct consequence of a tragedy in his immediate family in the environment of crime that continues to afflict South Africa and its people. We will miss Roger for his valuable contribution during his short stay at AECI and wish him and his family well in their new life.

Mark Kathan succeeded Roger as chief financial officer and financial director in September 2008. Prior to his AECI appointment, Mark had worked for 11 years at a JSE Limited-listed global packaging company where he held a senior finance position and was a member of that company's executive. He has experience in a broad spectrum of finance and business disciplines in South Africa and the rest of Africa.

In December 2008, Lex van Vught informed the Board that he wished to retire from his position as non-executive director of the Company. Lex had 40 years' involvement with AECI, including five years as its chief executive from 1998 to 2003. During that period his leadership in transforming the Company from an unfocused collection of largely commodity-based businesses into a specialty product and service solutions entity, was exemplary. On behalf of the Board, I would like to thank Lex again for his contribution in this regard. We will certainly miss him for the value that his insight and experience continued to add as a non-executive director.

Lex also served as chairman of the nominations and remuneration committees of the Board. These roles will be fulfilled by Richard Dunne from January 2009.

Alma Kennedy, Company secretary and legal advisor since 2007, will leave AECI at the end of March 2009. We thank her for her exceptional levels of dedication and professionalism during her tenure.

### Ethics and governance

AECI remains committed to maintaining its high standards of corporate citizenship, a high level of ethics and integrity, and proactive management of corporate responsibility issues. Safety, health and environmental issues are the first item on the agenda of management meetings of operating companies and of AECI's executive committee. Community awareness and support are guided and monitored by the corporate citizenship committee.

The Group adheres to best practices in corporate governance. In line with this, Group-wide training commenced in 2008 to improve employees' understanding of their rights and duties in terms of ethics in the corporate environment. Training in matters relating to competition law was also initiated.

### Outlook and strategic focus

It appears that the severe impacts of global recessionary trends will remain with us through 2009. The mining sector, a significant area of focus for AECI, has already suffered adverse impacts. Lower commodity prices are resulting in lower returns for our customers in this sector and those supplying the retail, manufacturing and automotive sectors have recorded some sharp declines in activity in recent months. The outlook for volume growth in 2009, therefore, is not promising.

The Company will need to be extremely vigilant of the overall business environment and avoid short-term decisions that could have adverse long-term impacts. 2009 will be a challenging year with much uncertainty and, therefore, the preservation of cash will be a priority. Specifically, the Board has requested AECI's management to:

- control working capital aggressively;
- progress key capital projects, while carefully reviewing all other capital expenditure;
- apply cost leadership principles across all businesses and activities; and
- maintain market share and margins through continued excellent service.

While 2009 is likely to be a challenging year, the Group will be well positioned for growth from 2010, when the environment is expected to improve and the benefits of the capital investment programme will begin to accrue.

I would like to thank all our shareholders, employees, business partners and other stakeholders for their continued support. I would also like to express my appreciation to AECI's management for their sustained efforts and to my colleagues on the Board for their wise counsel.



**Fani Titi**  
Chairman  
Woodmead, Sandton

23 February 2009