

## Review of operations: specialty chemicals

**Chemical Services Limited (Chemserve) is the specialty chemicals arm of AECl and manages a portfolio of 21 businesses, each focused on specific markets with common values of innovative customer service and bottom line delivery. Historically, the Chemserve group has grown by acquisition and by organic growth. It is currently undertaking a major capital investment programme.**

Each Chemserve business aspires to be the supplier of choice for customers in its markets, supported by the best technology available, a carefully designed service package, and with the lowest possible cost base. Technology is sourced from international partners and is also developed in-house. Full service package business models provide customers with innovative solutions to their chemistry-driven requirements and differentiate Chemserve from competitors in terms of skills and competencies.

Chemserve's strategy is to:

- expand its mining chemicals product and service offering in South Africa, the rest of Africa, and in other geographical areas where the full service model is valued and the mining profile fits the company's capabilities;
- grow its joint venture business in Brazil, based on oleochemical expertise it shares with its partner, and move into other sectors where the partnership has appropriate expertise;
- grow and manage its South African portfolio; and
- expand businesses in its portfolio into Africa, and into other territories where suitable markets exist.

### Business environment

The 2008 environment was distinctly altered by the mid-year global financial crisis. The first six months were driven by rapidly rising oil, commodity and specialty chemicals prices, and the fallout from South Africa's electricity crisis. Several product shortages resulted, concerns developed over the very high prices reached by some products and problems were experienced with shipping availability on some routes. The South African rand and the Brazilian real were strong and affected product pricing, exports, margins and transport costs. The decline in South African consumer spending was offset by global demand.

In the latter part of the year prices of many commodities declined substantially, with oil sliding to less than a third of its highs in five months. Prices of some other products dropped even faster. Rand product prices in some instances remained high, bolstered by the weakening currency. The Brazilian real also declined against major currencies.

### Performance

The excellent performance reported by Chemserve in the first half was sustained for the full year, despite the economic slowdown. Revenue increased by 50 per cent to R8,4 billion and trading profit was up 49 per cent to R851 million. Operating margins, at 10,1 per cent, remained at 2007's levels and volumes were 3,8 per cent higher. Organic growth accounted for most of this increase, aided in the second half by contributions from the Chemfit, Dustaway, Tenside Trading and Bergen Trading acquisitions.

Chemserve benefited from 2008's growth in mining, infrastructure construction and certain consumer-driven sectors but was adversely affected by the drop-off in automotive manufacture, and the white goods and furniture markets. Volumes remained static except in mining, agriculture and infrastructure construction.



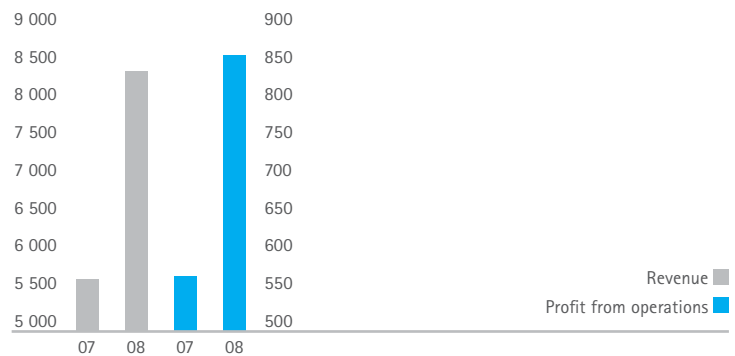
2008 saw a change for the group from the consumer-driven boom of prior years to a more sedate mining and construction focus, with continued support from some consumer areas. Parts of businesses within Chemiphos, Crest Chemicals (Crest) and Lake International (Lake) were repositioned during the year to align them more with their areas of focus.

Reduced consumer demand impacted directly, to a greater or lesser extent, on companies such as Akulu Marchon, Duco Speciality Coatings, Dussek Campbell, Industrial Urethanes and Resinkem. Some of these companies' customers have cut back their manufacturing activities to deal with high inventories and decreased demand.



Chemical Initiatives (CI), Industrial Oleochemical Products, ImproChem, Lake and Senmin benefited from strong demand in the precious and base metals mining industries.

Chemsolve Perlite enjoyed good demand from the wine manufacturing sector and Plaaskem benefited from the full integration of the UAP distribution business and an improved agricultural season. Chemsolve's manufacturing sector businesses produced mixed results. Plastamid continued to struggle with competition from imported specialty plastics and the drop-off in synthetic fibre waste from SANS Fibres. Chemiphos had a mixed performance in its specialised phosphoric acid markets but grew its fledgling construction chemicals business. Crest had an excellent year and again grew considerably, aided by its efficient trading and logistics systems and some acquisitions.



Financial performance (Rm)

## Chemserve management team

### <sup>1</sup> Frank Baker (55)

Managing director and an executive director of AECI. See page 18.

### <sup>2</sup> Mark Dytor (47)

Having joined Chemserve as a sales representative in 1984, and after successfully managing two group companies, Mark was appointed to the group's executive committee in 1998 and subsequently to its board. In addition to his portfolio of chairmanships, he has been tasked with the growth of Chemserve's mining business. Within the AECI Group, he is a non-executive director of AEL.

### <sup>3</sup> Oscar Loreti (45)

He joined Chemserve as group technical manager in 2007 and his qualifications include a Masters degree in technology mechanical engineering. Oscar is responsible for driving the group's SHE management system, ensuring that technical standards are set and maintained, and ensuring that expansion projects are completed professionally. Before joining Chemserve, he had gained experience in engineering-related activities in the steel industry.

### <sup>4</sup> Trevor Street (61)

Trevor started his Chemserve career as a sales representative more than 30 years ago. Several management positions followed and he was appointed an executive director on the Chemserve board in 1991. Since 1997, he has served as chairman of several Chemserve subsidiaries and his responsibilities include the pursuit of acquisitions for the group's growth.

### <sup>5</sup> Chris Kotze (43)

Chris joined Chemserve's quality assurance department in 1990. He was appointed to his current position as group information technology manager in 1998. His qualifications include a BSc degree and a diploma in Datametrics.



**<sup>6</sup> Edwin Ludick (44)**

Edwin joined the Chemserve group as a human resources manager in 1991 and was appointed to its executive committee in 2008. He is currently managing director of Chemserve Systems, having managed other group businesses prior to this. He has a BCom (Hons) degree.

**<sup>7</sup> John Mahlase (47)**

He is Chemserve's group human resources manager and, formerly, its industrial relations manager. Before joining the group as a human resources consultant in 1997, John had gained extensive experience in the discipline. He has an Honours degree in industrial psychology as well as an Advanced Diploma in labour law.

**<sup>8</sup> Chris Povall (51)**

Chris joined the company 11 years ago as financial manager and was appointed to Chemserve's executive committee and board as financial director in 2006. Prior to his Chemserve career, he had gained experience in the auditing field and had been financial director of a major media company. Chris has a BCom degree and is a qualified chartered accountant.

**<sup>9</sup> Schalk Venter (42)**

With a qualification in analytical chemistry, Schalk joined Chemserve Systems in 1991 as a sales representative. He was appointed managing director of this subsidiary in 1997 and moved to AECI Coatings in the same capacity in 2001. He was appointed to the Chemserve executive committee in 2005 and to its board in 2007. He is currently managing director of Akulu Marchon.



## Review of operations: specialty chemicals (continued)

Newly-acquired Chemfit exceeded expectations with a good performance in the markets it serves with niche specialised products and logistics. ImproChem had a steady year despite little volume growth in its markets and growing price pressures. It embarked on further innovative water saving projects, this time in Kenya. A re-engineered Chemserve Systems produced a pleasing improvement notwithstanding little market growth.

The paper chemicals sector, while under pressure worldwide, produced a reasonable year for Specialty Minerals SA and SA Paper Chemicals. Demand for leather hides in South Africa dropped with the decline in automotive manufacture, but Simitri had a steady year by growing market share. The strong Brazilian real in the first half-year negatively affected Resitec's customers, and the currency's fall in the second half resulted in significant losses from the revaluation of foreign currency loans.

### Capital programme

2008 was the second year of Chemserve's major capital programme, with spending of R390 million on approved capital of R1,2 billion for the construction and expansion of manufacturing capacity in guar, pelletised xanthates, carbon disulphide (CS<sub>2</sub>), acrylamide, polyacrylamide, oleochemicals and sulphonation. The capital programme has been resourced with experienced personnel, and project houses have been engaged to assist with the project management of the CS<sub>2</sub> and polyacrylamide plants owing to their size and complexity.

Managing the process has been complex with major global and South African projects demanding much of the local skills base and project resources, the availability and costs of components and steel fluctuating wildly, and the need for design work until late in the programme for some specialised processes.

Detailed design processes unearthed both shortcomings and opportunities in three projects which led to some delays and an additional capital requirement. The markets for the products from these plants have remained robust, particularly as part of their justification was import replacement.

At Senmin's site at Sasolburg, in the Free State, the integrated acrylamide and polyacrylamide facility will start up in the third quarter of 2009. It is a joint venture with Ciba Specialty Chemicals. The civils construction work is largely complete and installation of major plant items is underway.

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### Chemserve businesses

#### Akulu Marchon

supplier of raw materials to the cosmetics, toiletry and detergent industries.

#### Chemical Initiatives

manufacturer and supplier of sulphur-based chemicals and services to sectors such as agriculture, mining, pulp and paper, and packaging.

#### Chemfit

supplies traded and blended specialty chemicals to a wide range of industries, including water treatment, food, detergents, plastics, coatings, adhesives and sealants.

#### Chemiphos

manufactures poly-phosphoric acid (for catalyst manufacturers) and ortho-phosphoric acid (for, *inter alia*, beverage manufacturers); trades in pigments, nutraceuticals and construction chemicals.

#### Chemserve Perlite

manufactures and markets products derived from the mineral perlite. Customers are in sectors such as agriculture, food and beverages, mining, electroplating, industrial oils and construction.

The guar gangue depressant plant expansion was commissioned in the fourth quarter, in time to meet the projected increase in market demand. The first of two new xanthate collector lines was commissioned in the fourth quarter, together with a pelletising operation to produce a solid non-dusting product. The second xanthate line is due for installation in March and commissioning by mid-2009.

The methane-based CS<sub>2</sub> plant at Senmin is scheduled to come on line in mid-2009 and this will allow the phasing out of the outdated and environmentally unfriendly charcoal-based process. Finished product tanks are complete, ready for final imports of CS<sub>2</sub> before the new plant is commissioned.

Akulu Marchon's new sulphonation facility at Chloorkop, in Gauteng, will be commissioned in the second quarter of 2009. Plant structures are in place and major equipment is being installed.

Resitec's oleochemical fractionation column at Lages, in Brazil, was almost complete by year-end with commissioning planned for February 2009.

In the year, CI fully commissioned its elemental plant nutrient sulphur plant, at Umbogintwini near Durban, and initial sales demand has been very encouraging.

In addition to the major capex items already discussed, Chemserve spent R205 million on smaller capital and safety-related projects, including installations at customer sites, and R78 million on acquisitions.

Working capital was well managed, with the average ratio for the year being 16 per cent of sales.

### Portfolio changes and investments

Chemfit was acquired with effect from 1 July. ImproChem bought Dustaway, a specialised dust suppression operation. Crest acquired the coatings business of Tenside Trading, and Bergen Trading, a chemicals trading business. All these acquisitions were integrated successfully into the acquiring businesses.

By year-end, the proposed acquisitions of Cellulose Derivatives, a manufacturer of carboxymethylcellulose, and of CH Chemicals, a chemicals distributor, had been lodged with the Competition Commission for approval.

Chemserve sold 10 per cent of its 60 per cent holding in Resitec to MeadWestvaco. The latter also bought out the minority shareholders, resulting in Resitec becoming a 50:50 joint venture from the middle of 2008.

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#### Chemserve Systems

serves a diversified customer base in PVC stabilisers, electroplating, specialised lubricants, foundry resins, silicone-based products, industrial cleaning, non-destructive testing, fire protection, marine, metal conversion, coatings and polymer conversion.

#### Crest Chemicals

imports and supplies ex-stock a wide range of chemicals to all major industries including paint and coatings, oil and gas, food and beverages, pharmaceuticals and personal care.

#### Duco Speciality Coatings

the leading supplier of high technology paint finishes to the South African automotive manufacturing and refinish markets.

#### Dusseck Campbell

manufactures and distributes cable saturants, cable filling compounds and accessory products to power and telecommunication cable manufacturers.

#### ImproChem

provides energy solutions, water treatment, water optimisation and total water management to industry and to water authorities in Southern Africa.

#### Industrial Oleochemical Products

produces fatty acid derivatives and related products, as well as alkyd resins. Customers are in mining, chemicals, coatings, inks and adhesives, and plastics and rubber.

## Review of operations: specialty chemicals (continued)

### Safety

The Chemserve group achieved its safety targets, with a Total Recordable Injury Rate of less than 1 and a Lost-Time Injury Rate below 0,5 for the first time. Most of Chemserve's companies reported an improved performance and a decrease in the general severity of incidents. This improvement is attributable to increased senior management involvement, the focus on safety systems, structures and training at operating companies, and considerable effort from all employees to avoid unsafe acts.

Regrettably, a fatality occurred when a labour hire employee entered a vessel against instruction and died.

### Economic empowerment

Chemserve embarked on a process to enable each operating company and the group as a whole to generate a documented BBBEE scorecard on a regular basis. This has been followed by a strategic process in which each company has identified projects to improve low scoring areas.

### Strategic growth activities

#### Mining chemicals

Senmin continued its successful vendor management programme in South Africa and is expanding these services to Botswana, Namibia and Zambia. Australia and Indonesia are under consideration as additional markets. CI has developed its logistics chain to supply sulphur to numerous sulphur-consuming mining operations in Southern and Central Africa.

#### Step-out strategy

Resitec had a difficult first half with the strong Brazilian real slowing growth. Thereafter, the global financial crisis caused a dramatic decline in the Brazilian automotive market, reducing demand for Resitec's synthetic rubber emulsifier.

Raw materials have been obtained for the new fractionation column already referred to and pre-marketing of products has commenced. Chemserve continues to evaluate other acquisition possibilities in Brazil where price expectations may be tempered as a result of the financial crisis.

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### Chemserve businesses (continued)

#### Industrial Urethanes

manufactures and supplies polyurethane raw materials and blended systems. Products are applied in the automotive, mining, white goods, construction, footwear, furniture and other industries.

#### Lake International Technologies

manufacturer and distributor of products and services for explosives, fertilizers, food ingredients, coatings, glass manufacture and general chemicals.

#### Plaaskem

manufactures and distributes specialised agricultural chemical products, including insecticides, fungicides, herbicides, plant nutrition and fertigation products.

#### Plastamid

compounds and distributes engineering polymers and technical compounds for the South African and selected export plastic conversion markets.

#### Resinkem

manufactures and markets urea formaldehyde resins, formaldehyde solutions, urea, and resins for the timber, paper, animal feed and foundry industries.

## Challenges and outlook

The major challenge of 2009 will be the maintenance of margins established in 2008, and the conservation of cash.

The group will focus on completing its major capital projects in South Africa and in Brazil and on commercialising them as rapidly as possible.

South African power generation capacity remains a major source of concern. Without an adequate and reliable power supply, Chemserve cannot run its plants efficiently at capacity. Customers in the mining and industrial markets will be similarly affected.

Anticipating a challenging 2009, Chemserve will be looking to conserve cash wherever possible:

- deferring non-critical capital expenditure;
- continuing to carefully manage the working capital ratio;
- reducing the use of overtime and temporary employees;
- re-engineering businesses where necessary; and
- optimising human resources and costs.

At the same time, Chemserve will remain vigilant for opportunities which often emerge in difficult times.

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### Resitec (Brazil)

manufactures and supplies emulsifiers for synthetic rubber production and fatty acid esters for the adhesive, construction, surfacing and coating, mining and rubber industries.

### SA Paper Chemicals

a leading supplier of chemicals to the South African pulp, paper and board industries.

### Sinmin

manufactures and markets a comprehensive range of specialty chemicals for the mining industry, including froth, flotation and tailings treatment products. Further value is added to the customer by managing the full chemical extractives function on mines.

### Simitri

provides customers in textiles and tanning with specialty chemicals and services. The range includes biocides, liming auxiliaries, fungicides, tanning agents, defoamers and finishing products.

### Specialty Minerals SA

produces precipitated calcium carbonate products used as hi-tech, value-added filler and coating materials in paper production.