

I D E A S   M E A N   D Y N A M I C   F O R C E

***Nabaltec***



FINANCIAL STATEMENTS 2006

D Y N A M I C   F O R C E   M E A N S   P R O G R E S S

## BALANCE SHEET OF NABALTEC AG, SCHWANDORF, AS AT 31 DECEMBER 2006

ASSETS	31/12/2006 €	31/12/2005 €	EQUITY AND LIABILITIES	31/12/2006 €	31/12/2005 €
<b>A. FIXED ASSETS</b>			<b>A. EQUITY</b>		
<b>I. Intangible assets</b>			I. Subscribed capital	8,000,000.00	6,000,000.00
Concessions, industrial property rights and similar rights and assets, as well as licenses to such rights and assets	70,037.92	42,070.49	Conditional capital: € 3,000,000.00 (PY: € 0.00)		
<b>II. Property, plant and equipment</b>			II. Capital from profit participation rights	5,000,000.00	5,000,000.00
1. Land and buildings	5,635,646.57	5,829,155.18	III. Capital reserve	30,824,219.38	1,824,219.38
2. Technical equipment and machinery	10,245,679.02	9,506,586.41	IV. Profit carry-forward	1,056,055.18	595,187.56
3. Other fixtures, fittings and equipment	613,814.75	637,584.12	V. Net income for the year	783,220.80	1,460,867.62
4. Payments on account and assets under construction	9,843,206.23	1,688,800.36			
	26,338,346.57	17,662,126.07		45,663,495.36	14,880,274.56
<b>III. Financial assets</b>			<b>B. SPECIAL ITEM FOR FIXED ASSETS INVESTMENT GRANTS</b>	608,205.06	769,415.41
1. Shares in affiliated companies	162,930.73	162,930.73			
2. Loans to affiliated companies	4,148,981.89	1,531,618.40	<b>C. ACCRUALS</b>		
3. Other loans	546,832.00	0.00	1. Accruals for pensions and similar obligations	6,116,350.00	5,271,141.00
	4,858,744.62	1,694,549.13	2. Tax accruals	0.00	719,600.00
	31,267,129.11	19,398,745.69	3. Other accruals	4,211,915.93	3,095,062.67
<b>B. CURRENT ASSETS</b>				10,328,265.93	9,085,803.67
<b>I. Inventories</b>			<b>D. LIABILITIES</b>		
1. Raw materials and supplies	7,409,218.31	5,797,875.97	1. Liabilities to banks	7,554,594.06	5,453,928.55
2. Finished products and merchandise	6,107,393.62	5,365,985.36	2. Trade payables	7,380,720.26	5,226,536.19
	13,516,611.93	11,163,861.33	3. Liabilities to affiliated companies	248,330.06	0.00
<b>II. Accounts receivable and other assets</b>			4. Other liabilities	469,371.67	1,273,088.46
1. Trade receivables	2,424,124.53	2,671,695.01	▪ of which for taxes: € 174,316.59 (PY: € 699,371.01)		
2. Other assets	14,333,661.49	2,675,740.97	▪ of which for social security: € 9,215.36 (PY: € 324,481.18)		
	16,757,786.02	5,347,435.98		15,653,016.05	11,953,553.20
<b>III. Cash in hand and cash at banks</b>	10,546,142.78	760,013.09			
	40,820,540.73	17,271,310.40			
<b>C. PREPAID EXPENSES</b>	165,312.56	18,990.75			
	72,252,982.40	36,689,046.84		72,252,982.40	36,689,046.84

	1/1 – 31/12/2006		1/1 – 31/12/2005	
	€	€	€	€
1. Sales revenues		71,577,804.25		61,318,937.69
2. Increase in finished products		712,387.99		1,509,297.94
3. Other own work capitalized		148,208.86		262,615.54
<b>Total performance</b>		<b>72,438,401.10</b>		<b>63,090,851.17</b>
4. Other operating income		1,245,135.61		2,552,146.83
		73,683,536.71		65,642,998.00
5. Cost of materials:				
a) Cost of raw materials and supplies and purchased goods	38,644,847.54		34,702,503.48	
b) Cost of purchased services	198,610.15	38,843,457.69	113,272.73	34,815,776.21
<b>Gross profit</b>		<b>34,840,079.02</b>		<b>30,827,221.79</b>
6. Personnel expenses:				
a) Wages and salaries	10,750,041.22		10,251,381.18	
b) Social security and other pensions costs	3,116,822.40		2,565,946.08	
• thereof for pension costs: € 1,024,875.01 (PY: € 567,327.61)				
7. Amortization / Depreciation of intangible assets and property, plant and equipment	2,398,864.62		2,466,236.08	
8. Other operating expenses	13,608,473.84	29,874,202.08	12,209,211.89	27,492,775.23
		4,965,876.94		3,334,446.56
9. Income from long term financial investments	157,545.44		15.96	
• thereof from affiliated companies: € 157,545.44 (PY: € 0.00)				
10. Other interest and similar income	73,665.44		49,881.77	
• thereof from affiliated companies: € 0.00 (PY: € 41,158.13)				
11. Depreciation on financial assets and marketable securities	182,796.68		0.00	
12. Interest and similar expenses	1,324,651.18		965,112.88	
<b>Financial result</b>		<b>- 1,276,236.98</b>		<b>- 915,215.15</b>
13. <b>Income from ordinary activities</b>		<b>3,689,639.96</b>		<b>2,419,231.41</b>
14. Extraordinary expenses	2,107,839.45		0.00	
15. Extraordinary result		- 2,107,839.45		0.00
		1,581,800.51		2,419,231.41
16. Income taxes	760,796.19		921,737.27	
17. Other taxes	37,783.52	798,579.71	36,626.52	958,363.79
18. <b>Net income for the year</b>		<b>783,220.80</b>		<b>1,460,867.62</b>

**INCOME STATEMENT**

of  
**NABALTEC AG**  
**Schwandorf**

for the period from 1 January to 31 December 2006

# Nabaltec AG, Schwandorf

## Notes for the 2006 Financial Year

### **General Information about the Consolidated Financial Statements**

The annual financial statements were prepared in accordance with the accounting provisions of the Commercial Code, with due regard for the provisions of the Corporations Act and Articles of Association. The total cost method was used for the income statement.

Nabaltec AG, Schwandorf, is a large corporation in terms of § 267(3) of the Commercial Code.

### **Accounting and Valuation Methods**

The following accounting and valuation methods, which are unchanged from the previous year, were applied to the balance sheet and income statement items:

**Intangible fixed assets** are listed at their acquisition cost, minus scheduled straight-line depreciation. Depreciation in the year of addition was performed on a pro rata basis.

**Property, plant and equipment** are listed at acquisition or production cost minus scheduled depreciation.

Scheduled depreciation is performed using the straight-line method and typical useful life, based on the maximum allowable tax rates. Independently usable assets of up to EUR 410.00 were fully written-off in the year of addition pursuant to § 6(2) of the Income Tax Act. Depreciation in the year of addition was performed on a pro rata basis. Production costs do not include interest on borrowed funds.

**Financial assets** are listed at updated acquisition cost. If necessary, they are depreciated to fair value. Once the grounds for the lower valuation no longer exist, a write-up is performed back to the higher value.

**Raw materials and supplies**, as well as **merchandise**, are listed at acquisition cost, with due regard for the strict lowest-value principle. Acquisition costs are determined using the averaging method. Items whose fair value on the balance sheet date is lower than the acquisition cost are depreciated to the lower fair value.

**Finished products** are valued at production cost, with due regard for the strict lowest-value principle. The production cost includes, aside from directly attributable cost of materials and fabrication costs, a reasonable proportion of overhead material and fabrication costs. Interest on borrowings and the cost of general administration were not included in production costs. Finished products were consolidated into valuation units using group valuation pursuant to § 240(4) of the Commercial Code. Production costs of identical or nearly identical products were ascribed not to the individual items, but to the relevant group, using a weighted average value.

**Accounts receivable and other assets** are reported at nominal value. Recognizable individual risks are accounted for through individual allowances. The general credit and default risk in connection with trade receivables is account for through a general allowance.

**Liquid funds** are reported at nominal value.

Prepaid expenses relate to expenses prior to the balance sheet date which represent an expense for a certain time after that date. Reversal is made using the straight-line method in accordance with the passage of time.

**Subscribed capital** is listed at nominal value.

**Investment grants to fixed assets** were listed in the amount of the grant and are reversed over time based on the useful life of the subsidized investments.

**Accruals for pensions** are formed based on actuarial principles in accordance with the partial value method pursuant to § 6a of the Income Tax Act using an interest rate of 6% and the 2005 G benchmark tables of Dr. Klaus Heubeck.

**Other accruals** are formed for all recognizable risks and contingent liabilities, in the amount necessary based on the assessment of a prudent businessman.

**Liabilities** are listed at the repayment or performance amount.

### **Principles of Currency Translation**

Foreign-currency receivables and liquid funds are valued at the selling rate on the date of accrual or the balance sheet date, whichever is lower. Foreign-currency obligations are valued at the buying rate on the date of accrual or the balance sheet date, whichever is higher.

## **Information About the Balance Sheet**

### **Fixed Assets**

The development of the individual fixed asset items in the financial year is described on the next page.

### **Accounts Receivable and Other Assets**

Other assets consist primarily of accounts receivable from a factoring company from the sale of receivables (EUR 11.185 million), VAT refund claims (EUR 1.567 million), short-term loans (EUR 873,000), a petroleum tax refund claim (EUR 224,000) and corporation and trade tax refund claims (EUR 133,000). All accounts receivable and other assets have a residual term of less than one year.

Due to the long-term character of assets arising from pension liability insurance coverage, they were listed as financial assets in the reporting year, under the "other loans" item. In the previous year, they were listed as current assets, under "other assets." Last year's item was not adjusted.

The accounts receivable from a factoring company, in the amount of EUR 11.185 million, were listed under "other assets" in the 2006 financial year. In the previous year, EUR 1.596 million of those receivables were listed under "trade receivables." Last year's item was not adjusted.

The rise in accounts receivable from a factoring company over the previous year was attributable to the switch from financing factoring to maturity factoring at the end of the financial year.

## Equity

a) Subscribed capital EUR 8,000,000.00

The capital stock is divided into 8,000,000 no-par-value shares.

In the 2006 financial year, the capital stock was increased by up to EUR 2,000,000.00, to up to EUR 8,000,000.00, by resolution of the general meeting of 23 October 2006. Capital stock was then increased to EUR 8,000,000.00 through the issuance of 2,000,000 shares. Entry of the capital increase in the Commercial Register of the Local Court of Amberg was made on 23 November 2006.

Position on 1 January.2006 EUR 6,000,000.00

Capital stock increase EUR 2,000,000.00

Position on 31 December 2006 EUR 8,000,000.00

=====

b) Capital from profit participation rights EUR 5,000.000,00

Shareholders' equity includes profit participation capital in the amount of EUR 5 million. The scheduled term ends in 2012. Until then, the contracting parties have no routine termination right. The profit participation capital meets the requirements in IDW HFA 1/1994 for disclosure as shareholders' equity.

c) Authorized capital

As of 31 December 2006, the following authorized capital exists  
(to expire on 22 October 2011) EUR 3,000,000.00

By resolution of the general meeting on 23 October 2006, the management board, with the consent of the supervisory board, is authorized to increase the capital stock by up to EUR 3,000,000.00 through 22 October 2011 by issuing up to 3,000,000 new no-part-value bearer shares in exchange for cash and/or in-kind contributions, once or multiple times, and to decide as to the exclusion of subscription rights (Authorized Capital 2006/I).

d) Conditional capital EUR 3,000,000.00

By resolution of the general meeting on 23 October 2006, the capital stock was conditionally increased through the issuance of up to 3,000,000 no-par-value bearer shares (Conditional Capital 2006/I). The conditional capital serves exclusively to provide shares to holders of convertible and warrant bonds issued based on the authorization of the company's general meeting on 23 October 2006.

e) Capital reserve EUR 30,824,219.38

1 January 2006	EUR 1,824,219.38
Transfers	<u>EUR 29,000,000.00</u>
31 December 2006	EUR 30,824,219.38 =====

2,000,000 shares were issued at EUR 15.50 per share, each representing EUR 1.00 of the capital stock, resulting in a premium of EUR 14.50 per share, for a total of EUR 29,000,000.00.

f) Profit carry-forward EUR 1,056,055.18

1 January 2006	EUR 595,187.56
2005 net income	EUR 1,460,867.62
Profit distribution	<u>EUR -1,000,000.00</u>
31 December 2006	EUR 1,056,055.18 =====

g) Net income for the year EUR 783,220.80



## Special Item for fixed Assets Investment Grants

Investment grants to fixed assets are reversed in accordance with the useful life of the subsidized investments.

## Accruals

Other accruals consist primarily of personnel obligations (EUR 1.245 million), clean-up and disposal expenses (EUR 1.051 million), anticipated losses from pending transactions (EUR 205,000) and outstanding invoices (EUR 996,000). An additional provision for EUR 445,000 was formed for the processing of hydroxide solution and disposal of waste, in accordance with § 249(2) of the Commercial Code.

## Liabilities

The statement of liabilities below breaks down accounts payable and residual terms, indicating any securities which have been furnished:

	Total	Residual terms			Sum backed by security	Type of security
		Less than 1 year	1-5 years	Over 5 years		
	KEUR	KEUR	KEUR	KEUR	KEUR	
Liabilities to banks	7,554	1,544	3,129	2,881	7,554	Land charges, security assignment
Trade payables	7,381	7,381	0	0	0	
Liabilities to affiliated companies	248	248	0	0	0	
Other liabilities	469	469	0	0	0	
	15,652	9,642	3,129	2,881	7,554	

## Information about the Income Statement

### Sales revenues

Breakdown of revenue by geographical market:

	2006		2005	
	KEUR	%	KEUR	%
Germany	24,793	34.6	21,339	34.8
Rest of Europe	38,694	54.1	34,297	55.9
North of America	4,251	5.9	2,858	4.7
South America	648	0.9	123	0.2
Asia	3,417	4.8	2,720	4.4
Africa	190	0.3	346	0.6
Australia	11	0.0	0	0.0
	72,004	100.6	61,683	100.6
<b>Minus</b>				
Discounts and bonuses	-426	-0.6	-364	-0.6
	71,578	100.0	61,319	100.0

Breakdown of revenue by segment:

	2006		2005	
	KEUR	%	KEUR	%
Fillers	46,178	64.5	38,351	62.5
Ceramics	25,400	35.5	22,968	37.5
	71,578	100.0	61,319	100.0

### Depreciation on Financial Assets and Marketable Securities

Due to the changed exchange rate, depreciation in the amount of EUR 183,000 was performed on loans to affiliated companies in the reporting year pursuant to § 253(2) Sentence 3 of the Commercial Code in conjunction with § 279(1) Sentence 2 of the Commercial Code. The book value of loans to affiliated companies is EUR 4.149 million.

### Extraordinary Expenses

The extraordinary expenses item consists of the cost of the IPO, in the amount of EUR 2.108 million.

## Other Information

### Liability relations and other financial obligations

In accordance with § 251 and § 268(7) of the Commercial Code, the following liability relations must be noted:

		2006 KEUR
1.	Obligations arising from the negotiation and transfer of bills of exchange thereof, in favor of affiliated companies:	0
	KEUR 0	
2.	Obligations arising from guarantees, bills of exchange and check guaranties thereof, in favor of affiliated companies:	0
	KEUR 0	
3.	Obligations arising from warranty contracts thereof, in favor of affiliated companies:	0
	KEUR 0	
4.	Liability arising from securities for third-party obligations thereof, in favor of affiliated companies:	0
	KEUR 0	
<hr/>		
	Total	0
<hr/>		

The following other financial obligations exist which are of importance for assessment of the financial position:

	31 December 2006 KEUR	
a)	Obligations arising from rental, lease, service and consulting agreements	5,884
	Thereof	
	- maturing in less than 1 year	1,667
	- maturing in 1-5 years	4,217
	- maturing in over 5 years	0
	- to affiliated companies	0
b)	Obligations arising from investment contracts (orders)	9,594
	- thereof, maturing in less than 1 year	9,594

## Share Ownership Pursuant to § 285(11) of the Commercial Code

	Share in capital stock		Total shareholders' equity in past financial year *)		Earnings in past financial year *)	
	in %	in USD	in USD	in EUR	in USD	in EUR
<b>Direct holdings</b>						
Nashtec Management Corporation, Texas/USA	51.0	2,102.65	1)	1)	1)	1)
Nashtec L.P., Texas/USA	50.5%	208,163.26	-1,125,979.00	-855,217.23	-1,497,675.00	-1,188,914.03
<b>Indirect holdings</b>						
Stake in Nashtec Management Corporation:						
Nashtec L.P., Texas/USA	0.5%	2,102.65	-1,125,979.00	-855,217.23	-1,497,675.00	-1,188,914.03

\*) Shareholders' equity in foreign currency in the past financial year was translated at the exchange rate as of the balance sheet date. Earnings in foreign currency in the past financial year were translated using the average exchange rate in the financial year.

1) The disclosure of data as to shareholders' equity and earnings in the past financial year is omitted in accordance with § 286(3) Sentence 1 No. 1 of the Commercial Code due to secondary importance.

## Derivative Financial Instruments

In the course of the company's risk management system, derivative financial instruments are used in order to mitigate risks, particularly those arising from fluctuations in interest and exchange rates.

Market values are determined by independent financial services companies.

The nominal and market values of the financial instruments as of 31 December 2006 were as follows:

### Interest rate hedging

An interest rate and currency swap exists with a market value of EUR 67,611.35 as of 31 December 2006. The bank will receive CHF 4,457,400.00 and pay EUR 2,850,000.00. The interest rate and currency swap matures on 30 September 2011. The derivative interest rate and currency swaps serve to mitigate the interest rate and currency risk. Positive market values were not taken into account.

### Currency hedging

	31 December 2006		31 December 2005	
	Nominal value	Market value	Nominal value	Market value
	EUR	EUR	EUR	EUR
USD currency futures	868,121.57	38,850.22	4,361,519.28	-60,919.08
GBP currency futures	1,416,034.25	-65,499.28	697,836.71	-26,477.00

Currency hedging contracts are valued based on reference rates, with due regard for forward premiums and discounts. Provisions for anticipated losses from pending transactions were created in the amount of the negative market value. Positive market values were not taken into account.

## Employees

The average number of workers employed during the financial year is:

	31 Dec. 2006
	Number
Industrial workers	149
Employees	85
Marginal workers	13
	247

In addition, an average of 28 trainees was employed during the financial year.

## **Management and Supervisory Board**

In accordance with the articles of association, the company's management board consists of at least one person. The number of management board members is defined by the supervisory board. The supervisory board may select one management board member to serve as chairman. No management board member is serving as chairman at this time.

The members of the **management board** are (each serving since the date indicated):

**Mr. Johannes Heckmann**, since September 2006

Economic engineering graduate

**Mr. Gerhard Witzany**, since September 2006

Commercial graduate

Disclosure of the total remuneration paid to the management board is waived in accordance with § 285, Sentence 1 No. 9a of the Commercial Code, pursuant to § 286(4) of the Commercial Code.

A loan for EUR 150,000 was issued to management board member Mr. Gerhard Witzany by contract of 22 May 2003. The loan carried interest of 5.0% p.a., to be repaid beginning 30 June 2005 in equal annual installments of EUR 30,000 each. Early repayment can be made at any time. EUR 139,000 of the loan principal was repaid in this financial year. As of the balance sheet date, the loan amount was EUR 0.

## **Supervisory Board**

In accordance with the articles of association, the supervisory board consists of three members. At the time these Notes were prepared, the supervisory board included the following members (each serving since the date indicated):

**Dr. Leopold von Heimendahl** (supervisory board chairman), since September 2006

Retired physicist

**Dr. Dieter J. Braun** (deputy supervisory board chairman), since September 2006

Retired chemist

**Dr. Jürgen G. Heinrich**, since September 2006

Professor of engineering ceramics

The supervisory board members received a total of EUR 18,000 in remuneration for the 2006 financial year.

Schwandorf, 12 March 2007

Nabaltec AG

Management Board

Johannes Heckmann   Gerhard Witzany

Nabaltec AG, Schwandorf

Management Report for the 2006 Financial Year

### **Macroeconomic Situation**

The global economic growth stimulated the German economy as well in the course of the year. A positive trend was observed in both domestic and foreign demand, including all major industrial sectors which Nabaltec supplies: the ceramics and refractory products industry continues to benefit from the high demand for steel and other technical ceramics applications. Halogen-free flame retardants for plastics, which contain no hazardous materials, are increasingly entering the public spotlight and their use is being promoted by statutory measures and regulations.

The strength of the euro against the US dollar gives competitors from that monetary zone (USA, Asia) continuing cost (and thus competitive) advantages, which limit Nabaltec's potential sales growth despite the rising demand.

### **Industry Situation**

The company's major competitors, Almatis, Albemarle, Alcan and MAL, focus on different products and markets, to some extent. New competition can be expected above all from less specialized Indian and Chinese suppliers.

Prices for raw materials (smelter grade oxide, chemical grade aluminum hydroxide) reached a new high in the reporting year and are expected to consolidate at a lower level in the medium term, due in part to new capacity entering the market.

Demand for halogen-free flame retarding fillers (particularly aluminum hydroxide) continues to rise and is being stimulated by newly drafted fire safety regulations all over the world. Medium-term forecasts predict that global demand will continue to rise at a rate of over 6% a year. In order to keep up with this growth, which is attributable above all to fine precipitated aluminum hydroxide, Nabaltec commissioned a new production plant in the reporting year in Corpus Christi, Texas, together with its joint venture partner, Sherwin Alumina, with an initial capacity of 25,000 tons of fine precipitated aluminum hydroxide a year. Nabaltec AG also integrates Nashtec's production into its own distribution organization, so that that revenue can be reported as Nabaltec revenue.

The high utilization of global capacity further stabilized prices, allowing the company to increase prices in order to offset the average rise in costs.



In the specialty aluminum oxides and reactive alumina segments, there is still excess capacity in the market for less-refined products, while capacity in the market for highly refined products is clearly limited. Prices in the various segments are affected differently by competition in this respect.

## Revenue and Earnings

In its "**Functional Fillers**" division, Nabaltec's "**Flame-Retardant Fillers**" business unit, which offers the **APYRAL**<sup>®</sup> product range, focuses on halogen-free flame retardant fillers in the following market segments:

- coarse crystalline and mixed hydroxides for the casting resins market, as casting compounds in electrical engineering and as resins for building components;
- fine precipitated aluminum hydroxides (fine precipitated hydroxide) for the cable coating and insulation market.

The "**Additives**" business unit

- supplies boehmite qualities for the catalytic raw materials market; and
- will supply heavy metal-free stabilizers for the plastics market.

The goal of this focus is to attain quality leadership in the relevant segments with highly-efficient eco-friendly products, making the company one of the three leading suppliers worldwide.

In the **coarse crystalline hydroxide** segment, revenue increased by 20% (previous year: down 2%), while sales of **fine precipitated hydroxides** were 13% higher than the previous year (previous year: 16%). In the **boehmite** segment, sales increased by 204% over the previous year.

This division closed the year with 19% sales growth (previous year: 14%), comprising 64% of overall sales (previous year: 62%).

The "**Ceramic Raw Materials**" unit of the "**Technical Ceramics**" division focuses on the following markets:

- the refractory industry;
- wear-resistant ceramics;
- raw materials for technical ceramics; and
- the polishing agent industry.

The focus on highly-refined products was taken into consideration at all times in developing our qualities.

Sales of **NABALOX**<sup>®</sup> aluminum oxides decreased slightly due to the continuing focus on more highly-refined qualities, but revenue increased by 6% (previous year: 4%) as a result of the higher-quality product mix and price increases. The company is reformulating its polishing alumina in order to strengthen its qualitative leadership in that market. In the refractory segment, revenue from **SYMULOX**<sup>®</sup> synthetic sintered mullite rose by 10%, after slumping by 45% in the previous year, a development which can be explained by cyclical fluctuations in demand for refractory products in major orders from the glass industry.

In the "**Ceramic Bodies**" unit, Nabaltec's **GRANALOX**<sup>®</sup> product family is the global market leader, in terms of both quality and quantity, in ceramic bodies for engineering ceramics available over the counter, with an aluminum oxide content of over 92%. Its market position has been reinforced by joint developments with customers, further strengthening the company's very close relationships with customers and suppliers. Revenue in this segment increased by 25% due to a higher-quality product mix (previous year: 12%), so that revenues increased faster than sales volume.

This division closed the year with 10% sales growth (previous year: 0%), comprising 36% of overall sales (previous year: 38%).

In all, Nabaltec AG had sales of EUR 71.578 million (previous year: 61.319 million), 16.7% higher than the previous year, and overall performance rose by 14.8%, to EUR 72.438 million (previous year: 63.091 million).

## **The IPO of Nabaltec AG**

In order to generate over EUR 60 million in capital needed to fund Nabaltec's extensive investment program to support the company's future growth in all areas, the shareholders in Nabaltec GmbH decided in mid-2006 to transform Nabaltec GmbH, as it was then called, into a corporation, and to go public.

Together with the IPO partners, UniCredit Markets & Investment Banking (Bayerische Hypo- und Vereinsbank AG) and Berenberg Bank, a plan was formulated for rapid implementation of this decision.

Effective 27 September 2006 (for tax purposes: 1 January 2006), Nabaltec GmbH was transformed into Nabaltec AG. On 23 November 2006, the capital stock was increased by € 2,000,000.00, Nabaltec AG's shares were registered on 24 November 2006 in the Entry Standard section of the Frankfurt Stock Exchange and the 2,000,000 shares created by the capital increase, together with 1,335,000 shares held by the existing shareholders (including the greenshoe option), were made available to interested investors.

With an allotment price of € 15.50 per bearer share and an initial listing of € 16.50, all issued shares were successfully placed, generating net issue proceeds of € 28.9 million for Nabaltec, after deducting the cost of the IPO (€ 2.1 million), a sum which will be used to fund more ambitious growth projects over the long term.

The cost of the IPO has been listed as extraordinary expenses, and consists of commissions, consulting fees for legal and public relations consultants and public fees.

The new shareholder structure is heavily slanted towards institutional investors, predominantly from English-speaking countries. According to a notice issued in accordance with the Securities Trading Act, Threadneedle Asset Management Limited (with Threadneedle Asset Management Holdings Limited and Ameriprise Financial) held 5.03% of shares in Nabaltec AG as of 8 December 2006.

The price of Nabaltec stock has held steady in a highly volatile environment, reaching its starting value of € 16.50 once again on 29 December 2006.

## Financial, Earnings and Liquidity Position

As a result of the company's extensive investments in expanding its fine precipitated hydroxide capacity and building a new facility for the production of ceramic bodies Nabaltec AG's fixed assets increased to EUR 31.267 million (previous year: EUR 19.399 million).

The EUR 23.550 million increase in current assets, to EUR 40.821 million, is attributable to a 21% rise in inventories, to EUR 13.517 million, particularly due to an increase in the raw materials stocks, an increase in assets due to accounts receivable from the factoring company and a clear rise in cash in banks, reflecting the company's high liquidity.

Pension provisions increased based on the current opinion and pensions and accrued liabilities, which rose by 36.1% over the previous year, to EUR 4.212 million, due above all to an increase in provisions for rehabilitation of the evaporation building and outstanding invoices.

Total obligations increased by 30.9%, to EUR 15.653 million, due above all to long-term subsidized borrowings for development projects and uninvoiced services from the investment projects. Sufficient liquidity was secured at all times: the company did not utilize its available lines of credit.

Nabaltec's 16.7% revenue growth over the previous year, to EUR 71.578 million, generated an 18.8% increase in gross profit margin, to 46.4% (previous year: 44.8%). The 8% increase in personnel expenses over the previous year is attributable to an increase in the total number of employees, increases in collective wages and higher provisions for employee pensions. Moreover, the increase in other operating expenses was 11.5%, below the growth in sales.

Nabaltec AG's earnings of EUR 3.690 million (previous year: 2.419 million), before taxes and extraordinary expenses for the IPO, continued the positive earnings trend. This figure includes necessary provisions for contamination, waste disposal and infrastructure expenses.

## **Derivative Financial Instruments**

The currency hedging transactions existing as of 31 December 2006 for US dollars and British pounds, amounting to a total of EUR 2.284 million, serve to ensure receipt of payment for existing orders in 2007. According to a notice from the bank, a provision in the amount of EUR 66,000 has been formed to cover anticipated losses from pending transactions.

There is also an interest rate and currency swap for a nominal sum of CHF 4,457,400.00. According to a bank notice, the market value of this transaction is EUR 68,000, maturing on 30 September 2011. The derivative interest rate and currency swap serves to limit the interest rate and currency risk.

Nabaltec AG has assumed a guarantee vis-à-vis Bank of America for its share of Nashtec's obligations, in the form of a "Stand-by Letter of Credit". This guarantee expires in 2009, provided Nashtec complies with its obligations to repay the loan in two stages.

## **Procurement**

The supply of raw materials and energy was secured at all times based on medium-term supply contracts. Due to past development work, there is no dependence on specific raw material qualities.

The supply of steam and power is secured based on contracts of varying terms, in close cooperation with the Zweckverband Müllverwertung Schwandorf (Schwandorf Recycling Association). Those contracts also involve energy suppliers to ensure the availability of reserves. Gas and oil are procured through medium-term contracts.

Low-cost supply of raw materials for the Nashtec joint venture is ensured by long-term contracts with the joint venture partner, Sherwin Alumina, which supplies materials from its own production.

## **Production**

Due to investment in the fourth APYRAL<sup>®</sup> 40 CD production line, fine precipitated hydroxide capacity at the Schwandorf site was increased by another 5,000 tons, to 55,000 tons. The facility went online at the beginning of November 2006 and has been operating at full capacity since then. Customers continue to affirm our qualitative market leadership in that segment. Work has already begun on the construction of two

additional production lines, which will enable the company to meet the future demand for APYRAL® 60 CD, thus opening up new markets for the CD technology.

The introduction of a de-alkalization process will allow the company to further improve product quality and ensure consistent quality in the oxides and reactive alumina segments. Nabaltec is developing advanced production techniques, with the aid of an experimental rotary tubular kiln, in order to enable the definition of processing parameters in advance when materials of different qualities are used, thus reducing the need for experimentation and additional time if those materials are changed. The experimental facility also allows the company to develop oxides which are customized to meet specific market requirements on a testing facility scale.

Construction of the new facility for the manufacture of ceramic bodies and reactive alumina is largely complete, and ceramic bodies production is set to begin in the first quarter of 2007. Individual sections of the facility, for the production of reactive alumina, have been online since October. This facility, Nabaltec AG's largest single investment to date, will allow the company to actively exploit market potential which is known to exist, strengthen its market position by adding highly-specialized products, continue to supply customers as they grow and to develop new markets. The high demand for reactive alumina has induced Nabaltec to move forward the planned increase of its reactive alumina capacity to the first half of 2007.

After some minor alterations, including technical improvements and adjustment to development objectives, the Kelheim testing facility is now operating at full capacity. That facility allows Nabaltec to develop new products and processes, particularly in the fields of catalytic raw materials and stabilizers which do not contain heavy metals. The company has already succeeded in the development of new boehmites, which has encountered high market demand, and small-scale production is already underway in Kelheim. The facility can also be used to manufacture small and mid-size orders and to amass experience in meeting large orders, which can then be used to redesign the production facilities as well at the Schwandorf site as at Nashtec.

The project to introduce an integrated IT system for management and data compilation in the production segments has proceeded within the given timetable and has been expanded to additional segments.

## **Organization and Personnel**

Nabaltec AG's organization into two divisions and three service departments, operating as profit and cost centers, has contributed substantially to its precise market presence:

### **Divisions**

- **Functional Fillers**

Business units

Flame Retardant Fillers

Additives

- **Technical Ceramics**

Business units

Ceramic Raw Materials

Ceramic Bodies

### **Service Departments**

- Commercial services
- Technical services
- Laboratory

This organizational structure enables high accountability of our employees for results and effective cost control.

The recently introduced working group system in the Ceramic Raw Materials unit is in the process of thorough implementation, optimizing employees' sense of responsibility in establishing flexible working hours and managing the groups themselves.

With over 11% of its employees undergoing training as industrial sales clerks, IT specialists, chemical laboratory assistants and chemical workers, Nabaltec is doing more than its share to educate young employees. In the past year, 4 graduates once again scored among the best in the CCI district for the year.

The total number of employees (including management board and trainees) increased slightly, to 282 as of 31 December 2006 (previous year: 276).

## **Environmental Protection**

By successfully completing its audit under the ISO 14001:2004 standard, administered by the Technical Inspection Agency [TÜV] of Bavaria, Nabaltec has underscored its commitment to active protection of the environment.

The laboratory's repeat accreditation under the DIN EN ISO/IEC 17025:2000 standard furnishes proof of the center's high level of performance, enabling the acquisition of sewage analysis orders as well.

## **Quality Management**

By successfully completing its audit under the ISO 9001:2000 standard, administered by the Technical Inspection Agency [TÜV] of Bavaria, Nabaltec has underscored its high quality standards in all areas.

Routine internal audits ensure the maintenance and improvement of the quality management system.

Certification of Nashtec under the ISO 9001:2000 standard is planned for 2007 in order to document a consistent quality standard for both production sites.

## **Research and Development**

Research and development activities are focused on the following areas

- process development;
- energy optimization;
- improving existing products; and
- new developments.

Aside from improving the quality of our products, process development is directed towards the rational utilization of the various raw materials and optimized production of our specialty products while minimizing commodity products.

In view of its energy-intensive production process and the steady rise in energy prices, Nabaltec entered into a partnership with Shell Energy Efficiency in 2005, in the course of which considerable potential for reducing costs was discovered and successfully realized, particularly in connection with thermal processes. The ongoing optimization efforts are being implemented in full.



The "Functional Fillers" division is expanding the APYRAL<sup>®</sup>-CD product range in close cooperation with key customers. The development of new products is also aided by various research projects, some of which receive public funds, e.g. as part of an industrial research association working group.

The "Technical Ceramics" division is focused on further developing its product range in cooperation with customers and institutions. To this end, industrial research association working groups have been created with various industrial partners in this area as well.

The clear goal of Nabaltec AG in its product development and improvement activities in all areas is to offer superior quality and processing advantages to its customers.

## **Nashtec**

In 2005, the company joined forces with Sherwin Alumina to create the "Nashtec" joint venture in the US with the intention of building a production site on the grounds of Sherwin Alumina's aluminum oxide plant in Corpus Christi, Texas, capable of manufacturing 25,000 tons of fine precipitated hydroxide (APYRAL<sup>®</sup> 40 CD) per year.

The project was financed by Bank of America and partners. The total investment volume is about USD 32 million, with Bank of America contributing USD 22.4 million of the investment sum and the partners contributing the rest in proportion to their share.

The contracts state that Nabaltec AG is solely responsible for marketing Nashtec's production. Customer sales are to be handled by Nabaltec AG and future revenues are to be integrated into the existing factoring system, albeit with a clear separation between USD revenue and other revenue. For its marketing, customer administration, technical support and further development activities, Nabaltec is to receive 9% of the ex works price as reimbursement for its expenses.

The joint venture partner provides Nashtec with a workforce, raw materials, energy and infrastructure at cost, thus contributing substantially to an optimizing cost structure.

Construction of the facility began in September 2005. The facility went online in November 2006, delivering samples to customers for their approval. In December 2006, the first regular product deliveries were made to customers, in accordance with their specifications. After all optimization efforts are completed, the facility will reach nominal capacity in the first quarter of 2007, after which it will be able to fill customer orders.

This will consolidate Nabaltec's position as the second-largest supplier of fine precipitated aluminum hydroxide and the only supplier capable of offering production sites in the two centers of consumption, America and Europe.

## Outlook

The equipment of plastics and casting resins with halogen-free flame retardant fillers has found support in public discussion is increasingly becoming the standard in EU legislation, in the US and in Asia. This development has contributed to increased use and demand for aluminum hydroxide, which is already the dominant halogen-free flame retardant filler in terms of volume. The dynamic growth in this area is therefore expected to continue. Market studies by various institutes confirm our estimate that the annual growth rate will be at least 6%. The company's' introduction of the **APYRAL® 40 CD** quality has led to high utilization of production capacity, which will induce the company to make additional strategic investments in fine precipitated hydroxides in the coming years and to expand its product range by adding additional CD qualities in order to preserve the balance between supply and demand. In addition to the qualitative leadership, Nabaltec aspires to be the market leader as well.

Nabaltec's investment in the Nashtec production site in the US gives consumers of fine precipitated aluminum hydroxide the security of a global supply of **APYRAL® 40 CD** with consistently high quality.

Based on the state of the general economy, the ceramics and refractory industry is expected to continue to grow, and the situation in the industry points to a continuing rise in sales. Customers are continuing to shift towards increased use of fine-ground reactive aluminum oxide. Nabaltec has reacted to this development by making targeted investments in this area and developing new products. The reduction in costs due to the switch to smelter-grade oxide, a low-cost de-alkalization process and the company's positioning in reactive, low-alkali aluminum oxides foretells a long-term improvement in earnings.

Based on the development since 2005, Nabaltec Group expects its strong sales growth to continue in 2007, powered by an across-the-board increase in production volume in Schwandorf and Corpus Christi, as well as price increases. Orders on hand as of 31 December 2006 were about EUR 23.931 million above forecasts, indicating that demand remains lively. This trend has resulted in a continued improvement and stabilization in earnings. The supply of raw materials to the Schwandorf and Kelheim sites continues to be secured by medium-term contracts. The supply of the Nashtec joint venture is secured by long-term arrangement with joint venture partner Sherwin Alumina within the scope of the joint venture agreement.

## **Risk Management**

The company's innovative global activities in hotly contested markets involve entrepreneurial risks. By establishing a comprehensive risk management system and constantly improving risk management instruments in all areas, serious dangers to the company can be identified and eliminated. The starting point of risk management is identifying and assessing various risk types and profiles, which are then monitored and managed by the controlling department. Reports about operational risks and routine status reports are prepared for management and discussed on the highest level. The most important element in this system is comprehensive operational planning, including the identification of targets, accompanied by routine forecasts.

Nabaltec has introduced a strategic planning system in order to take advantage of medium- and long-term opportunities and identify risks. All relevant units are involved in the strategy development process. Risks arising from competition, tax and environmental law are mitigated by Nabaltec in advance by engaging experts. Quality assurance measures limit product and environmental risks. Such measures include e.g. certification of our activities under international standards, constant improvements to facilities and processes, the development of new and the improvement of existing products and participation in international professional committees.

Risk management also includes routinely testing the efficiency of hedging instruments and the reliability of controlling systems. Insurance coverage exists for casualty and liability risks, thus limiting consequences for the company's financial, earnings and liquidity position and preventing situations where the continued existence of the company is in jeopardy.

With the introduction of factoring in 2002, the percentage of insured payment claims increased further, producing a clear improvement in the company's liquidity position. Currency risks were limited in strategic fashion through currency hedging transactions involving US dollars and British pounds. Interest rate swaps and fixed-interest loan contracts are used to guard against the risk of medium-term interest rate fluctuations.

If necessary, the company responds to fluctuations in the demand for products and services in close consultation with employee representatives, within the bounds of the flexible working hours allowed under the collective bargaining agreement for the chemicals industry.

Due to our continuous surveillance of the markets of relevance for the company, as described above, as well as our constant efforts to improve our products and adapt to the needs of existing and potential customers, risks of future development do not currently exist.

There are no recognizable risks which could endanger the continued existence of the company, whether in the reporting period or in the future.

### **Major Transactions after the Close of the Financial Year**

No major transactions took place after the close of the financial year.

Schwandorf, 12 March 2007

NABALTEC AG

Management Board

Johannes Heckmann

Gerhard Witzany

## Auditor's Report

We have audited the annual financial statements prepared by Nabaltec AG, Schwandorf, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report for the business year from January 1, 2006 to December 31, 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law and supplementary provisions of the articles of incorporation are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and supplementary provisions of the articles of incorporation and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, March 16, 2007

AWT Horwath GmbH  
Wirtschaftsprüfungsgesellschaft

ppa. Chr. Bayer  
Wirtschaftsprüfer  
(German Public Auditor)

M. Rauchfuss  
Wirtschaftsprüfer  
(German Public Auditor)



**Nabaltec AG**  
Alustraße 50 - 52  
92421 Schwandorf  
Germany  
Phone: +49 9431 53-0  
Fax: +49 9431 53-260  
[www.nabaltec.de](http://www.nabaltec.de)