Uralita Group

The Uralita Group in 2005

The Uralita Group
in 2005

ECONOMIC AND MARKET CONTEXT

Once again in 2005 Spanish economic growth outpaced the European Union average and thus continued to close the gap with regard to the more developed countries in its environment. Gross Domestic Product increased by 3.4% (80 basis points higher than in 2004), although this growth stemmed mainly from gains in private and public consumption rather than from improvement in gross investment or competitiveness, which in the long run are the growth drivers of the economy.

Spain's rapid rise in GDP generated a 3.7% inflation rate which was higher than the rate in earlier years as well as the average rate for European Union countries. As a consequence the price differential between Spain and the eurozone increased, undermining the competitiveness of our industry.

The euro's strength vs. the dollar declined from the highs seen earlier in the year, finishing 2005 at 1.19 euros/dollar. This situation, together with a stable exchange rate, favoured the Uralita Group given its exposure to the Russian rouble which is closely linked to the US dollar.

The building sector in Spain remained strong in 2005

Housing construction in Spain continued to be strong in 2005 with a year-on-year rise in housing starts and in construction completion certifications of 6.2% and 5.6%, respectively, according to the Ministerio de Fomento. The fundamental reasons for this growth are the increase in migratory flows, the demand for second homes among Spanish nationals and foreigners and the trend towards smaller family units as the Spanish socio-cultural environment adapts to European standards.

The situation in some markets and higher crude prices affected Group margins

The European construction market in 2005 presented a very different picture. In Germany the number of homes constructed fell for the fifth straight year, dropping to approximately 215,000 building permits per year, which represents the same level of housing construction as in the 1940s. This decline had a significant impact on insulation sales in this region and, consequently, on the profitability of the business. Portugal's construction market also performed poorly: another year passed without signs of a recovery and there was no indication of a turnaround in the immediate future.

Nonetheless, other countries of key importance to the Uralita Group such as Russia, posted double-digit growth in housing permits, resulting in a highly satisfactory level of demand for insulation in those markets.

Along with the slump in the Central European construction market, the external factor that most affected the Uralita Group was the rise in oil and oil-based raw materials prices. This increase has a significant impact on the Group in the short term since it is major energy consumer due to the type of production processes that it carries out and the fact that some of the main raw materials used are derived from oil, most notably plastics. The rise in the costs of these materials increases manufacturing unit costs, but, due to the competitive dynamics of the sectors in which the Group operates, it is unable to pass these added costs on to the final customers with the necessary ease and speed. One insulating product, XPS, was especially impacted. Its main raw material, polystyrene, accounts for more than 50% of the total cost of the product, and the price of this raw material increased significantly in 2005.

Furthermore, the increase in fuel prices had a major impact on transport costs, an important factor when we consider that the Uralita Group moves approximately 900 lorries of finished goods daily.

Macroeconomic indicators and construction activity in Uralita Group's core markets

	2005	Spain	Germany	France	Russia	Poland	Portugal
	Population (millions)	43.8	82.5	60.2	142.9	38.2	10.5
	GDP (% annual change)	3.4	0.9	1.4	5.9	3.2	0.3
	CPI (% annual change)	3.7	2.1	1.8	11.0	0.8	2.5
	Housing starts (thousands)	729.7[1]	215.0[2]	398.0	440.0[3]	100.0	67.5[2]
New construction:	Building (% annual change)	4.0	-7.9	6.5	15.9	5.5	-5.7
	Residential (% annual change)	4.8	-9.8	10.3	15.5	2.5	-7.5
	Non-residential (% annual change)	2.2	-4.9	1.2	16.0	5.1	-2.5
	Civil work (% annual change)	6.9	-8.0	1.1	13.8	16.4	2.0
Renovation:	Building (% annual change)	3.7	-1.3	1.5	9.6	3.5	1.9
	Residential (% annual change)	4.4	-1.4	1.5	6.7	4.0	2.0
	Non-residential (% annual change)	2.4	-1.0	1.5	10.1	3.1	1.5
	Civil work (% annual change)	4.2	-3.6	1.5	5.1	4.5	2.0

Source: INE; BBVA; Federal Statistical Office Germany; EC; ISTAT; Bank of Portugal; Euroconstruct, CIA
(1) Source: Ministerio de Fomento (2) Figures given are for building permits due to the lack of figures for housing starts (3) Completed housing

LINES OF ACTION IN 2005

During 2005 the Group concentrated on four lines of action in order to respond to the economic situation

In response to the complex macroeconomic conditions in which it operates, the Uralita Group focused primarily on four lines of action in 2005: completing the divestment process, improving the business operating efficiency, redesigning the organisational structure and continuing to establish a common culture of execution in the Group.

1. Completion of the divestment process

The divestment process laid out in the 2004-2006 Strategic Plan was divided into two phases:

i) Immediate disposal of non-core businesses which had negative profitability and which, upon analysis, were identified as having no potential for recovering profitability in the medium term. This phase of the process was executed in 2003 with the sale of six businesses and the closure of two others.

ii) Unlocking of value of those non-core businesses for which an increase in profitability and subsequent disposal was seen as viable by the Group. Most of the disposals took place in this phase, since a series of action levers were identified in the Strategic Plan which enabled the Group to capture more value from the sale of these non-strategic assets. This phase was carried out over the years 2004-2005 and resulted in the sale of seven businesses (last one in January 2006).

With the sale of seven non-core businesses, the Group has now concluded the disposal of its non-core activities

In 2005, six non-core businesses were disposed of, most notably the Chemicals Business (Aragonesas Group) which was sold to the Ercros Group in May 2005 for €180 million free of debt.

In the wake of the disposals in 2005 and the others in 2003-2004, only those businesses earmarked as strategic and which will be springboards for future growth remain within the Group's scope.

Income resulting from the sale of the non-strategic assets amounted to €263 million which, together with the cash flow from operating income allowed significant reductions in the Uralita Group's debt.

Businesses	Disposal Date
Sanitary Ware	01/03
Insulation EPS:	
Barberá del Vallés	11/03
Alcalá de Guadaira	12/03
Tapolca (Hungary)	12/03
Stone Wool	12/03
Flat Ceramic	12/03
Promat	03/04
Cerámicas Estructurales	01/05
Lusofane	04/05
Tejas Brasil	05/05
Uracan	05/05
Aragonesas	06/05
Teczone	11/05
Coverings	01/06

EV/EBITDA average	x6.8

Now that all the divestments are complete and the balance sheet is in sound condition, the Uralita Group is well positioned to undertake the next phase of the Strategic Plan: profitable growth.

2. Efficiency improvements in the core businesses

In 2005 all core businesses introduced efficiency improvement programmes

In 2005 further measures were implemented to boost efficiency at core businesses.

While the Management Report on each business provides a more detailed description of the various initiatives, the main actions undertaken in 2005 are summarised below:

Insulation Business

Due to the unfavourable economic environment confronting the Insulation Business, a number of actions were undertaken with the aim of restoring the Business to expected levels of profitability. On the industrial side, it was decided to close the Wesel plant (Germany) and concentrate the production of piping insulation in Ursa's Hungary plant; in addition, production began on the second line of our Moscow plant in the high-growth Russian market. Among the sales initiatives undertaken were withdrawal from the industrial insulation market as well as discontinuance of the marketing of third-party products, a situation which had prevented our sales force from focusing on our main products. Operating units were concentrated in order to simplify business structure, and a plan was devised to relocate the headquarters from Frankfurt to Madrid.

Gypsum Business

The Gypsum Business continues to focus on profitable growth. Efforts were concentrated on boosting penetration of Pladur® compared to traditional dry wall partitions by means of promotions for groups of prescribers and distributional development. In addition, our Pladur® plant in Valdemoro is continually working on improving efficiency through systems of industrial management and on increasing production through improved industrial ratios.

In our Algíss® powdered gypsum business, measures were aimed at broadening the offering to customers through higher added-value products such as mechanically applied gypsum with perlite, and by promoting the use of silos.

Roofing Business

In 2005, the Roofing Business focused mainly on simplifying its structure to enable it to compete in this mature market in the future. Commercially, it consolidated all its brands into one under the name Cobert® and simplified its product portfolio in order to market its products in a more user-friendly and effective manner. This simplification also had an impact on the industrial measures implemented, in that the production of curved ceramic roof tiles in Spain was concentrated in Alfaro, cutting production costs, and that of mixed ceramic roof tiles in Alicante, Toledo and Outeiro (Portugal).

Pipes Business

The Pipes Business implemented a series of radical measures in 2005 to achieve an appropriate level of profitability. It disposed businesses and activities with low profitability for the Uralita Group or whose competitive position was weak, concentrating its workforce on the promotion of higher-margin products. On the industrial side, plants were specialised in order to optimise production costs. As for overhead costs, headcount was reduced in line with the reduction in the scope of the Pipes Business.

3. Adaptation of the organizational model

The more simplified Group structure following the disposals prompted an organizational restructuring

In the second half of 2005, the Group reviewed its organizational structure and that of its businesses, in a bid to:

- Reduce the complexity of the Uralita Group after three years of boosting core-businesses' efficiency and shedding non-core businesses.
- Reduce the resources that the corporate centre needs to plough into supporting the businesses, having established a management culture and processes common to them all.
- Seek operating synergies between businesses, once Uralita had managed to implement those Group's common platforms synergies.
- Focus the corporate centre on the Group's strategic development, particularly through acquisitions.

As a consequence, the organisational change consisted of the following:

- Downsizing the corporate centre, adapting its costs to a sector that imposes ever greater competitiveness and focusing the corporate centre's efforts on growth through acquisitions
- Transferring to the businesses the functions developed or overseen by the corporate centre over the last three years, especially in the areas closest to operations (purchasing, information systems, human resources, legal, etc.).
- Setting up two General Managements for the Uralita Group, one for the Insulation Business (Ursa) and another that groups together the Gypsum, Roofing and Pipes Businesses (Uralita Iberia).
- Ursa's operating units were restructured and their total number was reduced, thus cutting overhead costs. In addition, the decision was made to relocate the Frankfurt headquarters to Madrid to ensure that the Group's values and culture were solidly implanted and to achieve the highest possible degree of synergies among Uralita's various businesses.
- At Uralita Iberia, overhead costs were reduced through the organisational consolidation of its three Businesses: Gypsum, Roofing and Pipes. This new situation will also allow the sharing of industrial best practices and an ongoing analysis of joint commercial opportunities.

4. Progress in instilling the Group Culture

The culture of the Uralita Group consists of seven values that constitute the basis for the growth in our project

The culture of the Uralita Group consists of seven values that constitute the basis for the growth in our project at both company and personal level. In 2005, the Group worked in the development of each one of its values:

Corporate spirit

In line with the objective of becoming an increasingly solid Group, the creation of the General Management of Uralita Iberia, which groups together the Gypsum, Roofing and Pipes Businesses, and the transfer of Ursa's headquarters from Frankfurt to Madrid will undoubtedly promote the Corporate spirit and culture and the consolidation of our values.

Transparency

Increasing transparency is an ongoing objective in the Uralita Group. To this end, in 2005 the Board of Directors incorporated all best practices in relation to Corporate Governance likely to generate value by increasing transparency and enhancing the information available to all stakeholders: shareholders, workers, suppliers, customers, markets, and the financial community in general. Moreover, the Group promoted two-way, direct communication with its shareholders and institutional investors through the Investor Relations Department and through the corporate website and also strengthened internal communication channels through shared information areas and the corporate intranet.

Openness to change

The Group continues to work to ensure that its values are fully implemented throughout the organization

The Uralita Group is open to rethinking the business model at any time in order to be a leading force for change in our environment. In 2005, the Insulation and Roofing Businesses made an in-depth study of their industrial structure and the Pipes Business completely restructured its business.

Self-achievement mindset

This value, which is the driver of any professional or personal project undertaken, is represented in the Uralita Group by all the people making up its human capital and who through the motivation which they demonstrate in their work day in day out, promote the growth of our company. In 2005, Uralita implemented policies for improving human resources, quality, the environment and technology, with the objective of enhancing efficiency every day in every one of the processes we undertake.

Ambition for excellent results

One of the priorities of the Uralita Group is to achieve profitable and durable growth that maximises long-term value for our shareholders. In 2005 the Group completed the process of disposing of non-core business and consolidated its portfolio with the four core businesses defined in 2003 – Insulation, Gypsum, Roofing and Pipes. These divestments improved the Group's financial situation by significantly cutting debt, and boosted the operating situation by focusing on businesses in which the Group can compete thanks to its scale, abilities and competitive position.

Respect for and continuous development of people

Our employees are the key to making Uralita a leading Group. In 2005, Uralita took measures to enhance the job quality, working conditions and health of all the Group's employees. During the year the Group continued the Human Resources Development and Training Plans initiated in earlier years which aim to provide the necessary tools and management skills to help staff to better perform their jobs and achieve their personal and professional objectives, thereby positively affecting the Company's results.

Social responsibility and commitment

In 2005 the Uralita Group, in collaboration with all of its employees, took part in various activities to make a reality of this value to which we all subscribe. Among the actions undertaken were: the Urality Aid Project (helping the victims of the Asian tsunami), the "Donate your Mobile" Campaign (the proceeds of which were spent on education and integration projects for the most needy), cooperation with Intermón Oxfam and the NGO Tierra de Hombres, etc.

2005 RESULTS OF THE URALITA GROUP

2005 saw the Group's second highest results in the last ten years with a significant reduction of debt

The main figures for 2005 are as follows:

Figures in millions of euros	2005	2004	2003
Sales	**1,104.6**	**1,314.1**	**1,314.6**
EBITDA	**150.5**	**189.7**	**162.0**
EBITDA margin	13.6%	14.4%	12.3%
Net profit	**53.6**	**60.8**	**-26.4**
Net profit margin	4.9%	4.6%	-2.0%
Net Income attr. to cont. company	**35.2**	**45.2**	**-41.9**
Free cash flow	**188.4**	**185.6**	**83.8**
Net financial debt	**140.1**	**292.0**	**451.1**

Consolidated sales totalled €1,104 million, with sales made outside of Spain accounting for 49% of the total. This figure includes the Chemicals Business's first five months of the year. The sales of its core businesses grew 0.6% compared with 2004.

Consolidated EBITDA for 2005 stood at €150.5 million. The decline compared with 2004 is due primarily to the smaller profit from the non-core businesses that were sold and the fall in EBITDA in the Insulation Business, caused by the weak German market and the rise in raw material prices. The Uralita Group reported an EBITDA margin of 13.6% in 2005, versus 14.4% recorded in 2004.

Despite the results from the Insulation Business and the reduction of the Group's scope, net profit amounted to €53.6 million, with a margin over sales of 4.9%, up 0.3pp on 2004.

Net profit attributed to the controlling group in 2005 totalled at €35.2 million, the Group's second highest profit in the last ten years.

The operating profit achieved, together with the disposals carried out, enabled the Group to maintain its investment programme, generating free cash flow of €188.4 million and slashing Group net debt to €140.1 million (from €292 million at the end of 2004).

STRATEGIC PRIORITIES FOR 2006

Increase the efficiency of current businesses

One of the Uralita Group's priorities for 2006 is to boost business profitability. In pursuit of this objective the Group will benefit from the improvements made in 2005 (which in many cases will bear fruit in 2006) and other initiatives to be implemented in 2006.

The Insulation Business is continuing with an aggressive cost-cutting plan at all levels, optimising its production capacity and implementing price increase initiatives to pass on rising raw material and energy costs to the end customer.

The Pladur® Business is continuing to work to reduce the unitary manufacturing cost, whilst the powdered gypsum business, Algíss®, is developing products with higher added value, both of which measures are aimed at boosting profitability.

The Group will benefit from the improvements introduced in 2005 and others to be carried out in 2006

The Roofing Business has undergone major restructuring and is investing to hone the technology used in its production processes with the aim of supplying a better quality product.

Finally, the Pipes Business underwent a major restructuring process in 2005 to become an efficient producer in the market in which it operates, with the aim of recovering margins lost as a consequence of the increase in raw material prices, competitive pressure and the slowdown in public works contracts.

The Company also simplified the structure of its central offices in 2005 to adapt it to its new business portfolio. This will also help improve the profitability of the Uralita Group as a whole.

Profitable growth

The Uralita Group has completed the process of restructuring its business portfolio by disposing of all non-core businesses, and it is now ready to tackle the next stage of its Strategic Plan: Growth. It has the necessary assets and has defined the priorities that will drive this growth.

The Group has the assets and has defined the priorities which will drive growth

With regard to assets, the Group has:

- A sound financial structure with a Debt/EBITDA ratio of 0.9 at the end of 2005. Assuming normal debt levels in the sector, the Group will be able to incur significant further debt for significant investments.
- A corporate centre that, following the reduction and transfer of operating functions to businesses, is focused on growth.
- A focused and simplified organisation, thanks to the new structure with Ursa and Uralita Iberia, able to unlock resources for the integration of new acquisitions.
- Proven management and integration processes.

The growth priorities for each business take into account a series of internal features (strategic position of the business, internal management capacity) and external characteristics (expected market performance, production capacity and utilisation, competitive dynamics, etc.).

Business-by-business priorities are therefore as follows:

- In our Insulation Business the objective is to increase our market share in the countries in which we are already present and to explore growth opportunities in other European markets.
- In Pladur®, our aim is to maintain our market leadership of plasterboard, which means our production structure must be able to meet projected future growth in demand.
- In Powdered Gypsum, Algíss®, our aim is to improve our market share in the Iberian Peninsular, consolidating our position as a market leader.
- In Roofing, the Uralita Group will seek to consolidate its leadership position in the Iberian tiles market through its Cobert® brand.
- Finally, the Pipes Business is expected to maintain its leadership position in Spain. Once the desired level of profitability had been achieved for the business it will be possible to consider growth opportunities in new international markets.