

BUILDMAX REVIEWING GROWTH STRATEGY AFTER TOUGH YEAR

As previously cautioned, JSE opencast mining contractor and construction materials supplier, Buildmax, suffered a tough year to February 2010 (“the year”). Difficult trading conditions exacerbated by the significant decline of the equipment resale markets in both mining and construction contributed to significant impairments that saw a substantial loss in profits. The group is about to embark on a rights issue with the goal of injecting upward of R150 million capital into the business to strengthen the balance sheet, support working capital and facilitate a growth strategy. Brait, which holds 24,8% in the group, has indicated a willingness to underwrite a significant portion of the rights issue subject to certain conditions.

The group reported a 5% increase in revenue to R1.8 billion, but earnings before interest, tax, depreciation and amortisation (“EBITDA”) dropped to R227.5 million. Accordingly headline losses per share amounted to 5.9 cents compared to headline earnings per share in the previous year of 13.4 cents. Despite reducing gross debt from R931 million to R660.3 million, net asset value per share fell to 60.5 cents from 157.5 cents in 2009. After extensively reviewing its depreciation estimates and residual values in consultation with external experts, the group’s earthmoving equipment and vehicles were devalued at year-end by R422 million. The continued deterioration in trading conditions and uncertain outlook resulted in goodwill and intangibles being impaired by R647.3 million.

Executive chairman Terry Bantock attributes the group’s poor performance in part to the collapse of the second-hand equipment market, on which Buildmax’s *Mining Services* is dependent for sustainable profitability. “The business model of our mining services businesses, acquired in 2008, is built on a set equipment replacement cycle and on a reasonable second-hand market that ensures acceptable used equipment values. The global economic crisis released a flood of equipment onto the second-hand market resulting in values decreasing by as much as 50%.”

Bantock further explains that the initial strategy to counter the weak used equipment market by extending the life of existing equipment was unsuccessful. “The spike in maintenance costs, disruption to productivity and need to hire-in more subcontractors escalated our overheads disproportionately to any benefit from using the existing equipment for longer.” The strategy was therefore scrapped and instead, a more conservative fleet valuation model has been employed going forward.

Tough trading conditions eroded margins and Buildmax was unable to pass the increase in costs on to its customers, preventing *Mining Services* from translating its 15% increase in revenue to R1.4 billion into any profit growth. “The business unit’s woes were further compounded by abnormal rainfall for five months of the year which caused excessive down time on all active projects during the year.” The loss before tax of R658 million included more than R600 million of write-offs.

Bantock explains that *Mining Services* has acted quickly to reverse its fortunes terminating loss-making contracts, specifically in Vukuza Earth Works. “A hard line was necessary to ensure future growth”. He adds: “While we appreciate that cutting the *Mining Services* client base increases exposure to single client default, we believe

this risk is sufficiently mitigated by the benefits, namely the remaining contracts' profitability and our ability to better manage fewer contracts."

Despite a 19% drop in overall revenue to R424 million Bantock is reasonably satisfied with the trading results of the *Construction Materials* businesses with the exception of the Bricks and Blocks division where delays in the commissioning of a new kerb plant resulted in lost revenue. The aggregates and quarries division repositioned itself wherever possible to focus on infrastructure projects and the strategy yielded positive results. Looking ahead he is more cautious. "Levels of activity in the construction sector continue to decline with many large-scale infrastructure projects coming to an end and very few new tenders being awarded. In addition private sector investment in construction is only expected to improve late in 2010 or early 2011. Together these factors result in a muted short- to medium-term outlook for the business unit."

Bantock is confident that the coal sector continues to offer growth opportunities for Buildmax. "Coal is still the world's cheapest and most abundant energy source which should ensure its ongoing attractiveness. Eskom will continue to need coal to generate electricity for decades to come. Demand for thermal coal from China and India is increasing and export capacity is being boosted at all major ports and supported by Transnet's undertaking to increase its rail-to-port capacity." Operational issues aside, his primary concern is the capital intensive nature of *Mining Services*' businesses. Reluctance on the part of banks to finance the purchase of new equipment in the absence of a significant deposit and lack of a guaranteed buy back from equipment suppliers have increased the risk of operating in this sector. To this end he says Buildmax will look to improve margins by targeting additional business opportunities that are less capital intensive in the greater coal mining value chain.

Bantock concludes that any outlook is subject to economic and market conditions "and at this early stage in South Africa's economic recovery that is difficult to forecast with certainty". He is nonetheless positive that the revised strategies for growth, fleet management and capital expenditure, bolstered by a successful capital raising and industry prospects, should enable the group to meet growth objectives.

Buildmax's share closed Monday at 36 cents.

Ends.

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