# A strong platform for growth:
# Innovation ‣ People ‣ Partnerships

ELECTRONIC MATERIALS

Annual Report & Accounts 2012

See under flap for
AZ at a glance

# About AZ

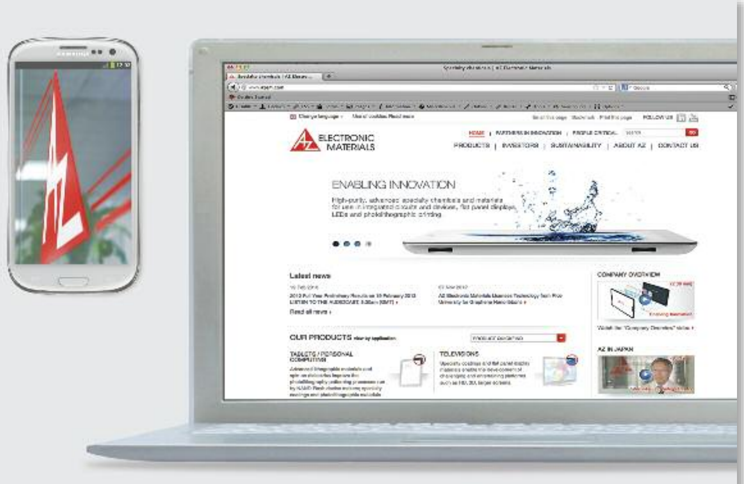
AZ is a leading global producer of high quality, high-purity specialty chemical materials for the fast growing electronics market. Our materials are widely used in integrated circuits and devices, flat panel displays and light-emitting diodes.

We are a critical partner to the leading global electronics players because our chemical technology allows them to enhance existing processes and innovate new products. This is vitally important in today's fast changing digital world where there is increasing demand and a drive towards smaller, faster, more powerful and less expensive technology.

AZ has a global presence with a focus on Asia, the centre of the world's electronics industry. We employ some 1,100 skilled and dedicated people who are passionate about driving AZ forward and achieving success for our customers.

**AZ online:**

Find out more about AZ, its products, operations and investor relations at:
www.azem.com



## AZ at a glance

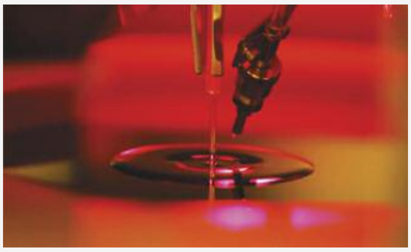
# Who we are and what we do

AZ is a leading global producer of high quality, high-purity specialty chemical materials for the fast growing electronics market. Our products enable the manufacture of integrated circuits ("ICs") and flat panel displays ("FPDs") that are integral to a wide variety of electronic devices and applications, including computers, flat screen televisions, telecommunications devices, industrial and automotive applications, and other consumer and industrial products.

# Our business divisions

During 2012, the AZ Group had three divisions each defined by the industries they serve:

### IC Materials



The IC Materials Division produces chemicals for the semiconductor industry. The division manufactures niche products such as dielectrics, underlayers, yield enhancers, CMP slurries and pattern enhancers, as well as conventional products consisting of IC photoresist (light-sensitive material), thick film resists, edge bead removers and other ancillary products.

AZ's chemicals are critical to the production of transistors that are used in memory chips and other microchip components.

68%
Group revenue contribution

See Operating Review: pages 26 to 27

### Optronics

The Optronics Division produces chemicals for the FPD, lighting and energy industries. The division produces FPD photoresist (light-sensitive material) for FPDs and photoresist, ancillaries and silicon chemistry based products for other industries.

AZ's chemicals are critical to the picture quality of FPDs, the functionality of touch screen displays and the brightness of light-emitting diodes ("LEDs").

30%
Group revenue contribution

See Operating Review: pages 28 to 29

### Printing and Other

The Printing and Other Division produces photolithographic printing chemicals for printing plates, which are used in the printing industry.

AZ's materials are critical to the production of printed materials such as newspapers, magazines and books.

Note: From 1 January 2013, this division has been absorbed into the IC Materials Division and will no longer be reported as a separate segment. This is explained on page 29.

2%
Group revenue contribution

See Operating Review: page 29

# Our customers

Our global presence and Asia focus ensures that we foster close working relationships with all the key IC, FPD and printing manufacturers.

# End markets

Our customers are IC and FPD manufacturers and they depend on specialty chemical materials to drive their technology to the next level of development. Specialty chemicals enable IC manufacturers to produce smaller microchips with a higher transistor density. For FPD manufacturers, electronic materials are vital for the creation of advanced technology products. The importance of our materials to these manufacturing processes means that the industries we serve have certified supply chains that demand high levels of purity, consistency and reliability.

**Tablets and personal computing**

**Information technology**

**Mobile communications**

**Consumer electronics**


## Enabling next-generation devices

### How AZ's materials expertise is making a difference

**AZ's materials expertise enables our customers to produce ICs and FPDs with enhanced performance characteristics for devices such as smart phones, including Samsung's Galaxy series and the Apple iPhone 5 shown here.**


Functionality
**Touch panel**
AZ's materials expertise
**FPD photoresist**
Touch key materials for patterning of advanced touch-sensor structures – the main interface used to provide information at your fingertips.

Functionality
**Flat panel display**
AZ's materials expertise
**FPD photoresist**
Patterning materials for TFT Array and colour filters – advanced photoresists that are critical to achieving enhanced resolution and brightness.

Functionality
**Flash/DRAM memory**
AZ's materials expertise
**Dielectrics and anti-reflective coatings**
Yield and pattern enhancement materials – products that allow our customers to further miniaturise and increase the memory capacity in consumer devices.

Functionality
**Microprocessor**
AZ's materials expertise
**Dielectrics and anti-reflective coatings**
Planarisation and pattern enhancement materials – products that allow advanced integration of new designs of processor chips, providing increasing instructions-per-second at lower power consumption.

Functionality
**Mobile phone module**
AZ's materials expertise
**Anti-reflective coatings**
IC Photoresist, EBR and other ancillaries – products which provide circuit patterning and advanced packaging integration for today's high-demand data communications on 3G and new 4G networks.

# Our global presence, Asia focus

AZ operates in 10 countries, namely China, France, Germany, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and the USA. It also has corporate and support services offices in Hong Kong, Luxembourg and the UK.


## Asia

| | |
|---|---|
| Location: | **Hong Kong (China)** |
| Type of facility: | Support services |
| Employees: | 19 |
| Location: | **Suzhou (China)** |
| Division served: | IC Materials and Optronics |
| Type of facility: | Manufacturing |
| Employees: | 68 |
| Location: | **Anseong (South Korea)** |
| Division served: | IC Materials and Optronics |
| Type of facility: | Manufacturing/R&D |
| Employees: | 139 |
| Location: | **Shizuoka (Japan)** |
| Division served: | IC Materials and Optronics |
| Type of facility: | Manufacturing/R&D |
| Employees: | 259 |
| Location: | **Hsinchu (Taiwan)** |
| Division served: | IC Materials and Optronics |
| Type of facility: | Manufacturing/R&D |
| Employees: | 139 |
| Location: | **Maharashtra (India)** |
| Division served: | Optronics |
| Type of facility: | Manufacturing |
| Employees: | 26 |

Employee numbers (including country sales people) as at 31 December 2012

## USA

| | |
|---|---|
| Location: | **New Jersey** |
| Division served: | IC Materials |
| Type of facility: | Manufacturing/R&D |
| Employees: | 162 |
| Location: | **South Carolina** |
| Division served: | IC Materials |
| Type of facility: | Manufacturing |
| Employees: | 32 |

## Europe

| | |
|---|---|
| Location: | **London (UK)** |
| Type of facility: | Support services |
| Employees: | 42 |
| Location: | **Lamotte (France)** |
| Division served: | IC Materials |
| Type of facility: | Manufacturing/R&D |
| Employees: | 37 |
| Location: | **Wiesbaden (Germany)** |
| Division served: | IC Materials, Printing and Other |
| Type of facility: | Manufacturing/R&D |
| Employees: | 161 |
| Location: | **Luxembourg** |
| Type of facility: | Corporate office |
| Employees: | 1 |

## Asia

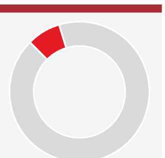
80%
Revenue by geography

## USA

12%
Revenue by geography

## Europe

8%
Revenue by geography



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Our business
## Performance highlights 2012

# A strong underlying performance in a challenging year

**US$793.9m**
Group revenue

**82%**
Revenue from market leading positions

**US$262.4m**
EBITDA

**35.4 cents**
Adjusted Earnings per Share

**13.1 cents**
Total dividend per share

**1.1 times**
Leverage (x EBITDA)

### Financial highlights

- Group revenue US$793.9m, in line with 2011 (at constant currencies[1], up 2%)
- EBITDA[2] US$262.4m, up 1% (at constant currencies[1], up 1%)
- EBITDA margin[2] maintained at approximately 33%
- Operating profit US$150.7m, in line with 2011
- Adjusted Earnings per Share[3] up 1% to 35.4 cents per share
- Strong cash flow reduced net debt by US$54.0m to US$289.4m
- Recommended final dividend of 9.1 cents per share, making a total dividend for the year of 13.1 cents per share, up 7%
- Group debt refinanced; new facilities in place of approximately US$500m

### Operational highlights

- AZ holds the No.1 or No.2 market share in products that accounted for 82% of Group revenue (2011: 82%)
- IC Niche outperformed underlying markets driven by demand for yield enhancement colloidal silica materials
- Optronics Division revenue up 6% driven by customer wins
- Continued focus on new and innovative materials for next-generation semiconductors and advanced displays
- R&D and capex spend maintained at 7% and 6% of Group revenue respectively
- Plant expansions completed in Taiwan and South Korea to provide local customers with shorter and more secure supply chains

Note:
1. **Constant currency** movements calculated by comparing 2012 results with 2011, retranslated at weighted average 2012 exchange rates.
2. **EBITDA** is defined as operating profit before depreciation and amortisation of intangible assets. For the years 2008 to 2010 EBITDA was further adjusted for exceptional items, and monitoring fees. There were no exceptional items or monitoring fees impacting EBITDA during the 2011 and 2012 financial years. The requirement to pay monitoring fees to AZ's previous shareholders ceased on 3 November 2010. **EBITDA margin** is calculated by dividing EBITDA by revenue.
3. **Adjusted Earnings per Share** is Adjusted Profit after Tax divided by the weighted average number of shares in issue during the year.

Our business
## Chairman's statement

# AZ delivered a solid performance in 2012 against the backdrop of continuing global economic uncertainty

### Overview

AZ's second set of full year results were in line with expectations and represented a solid performance in 2012. Against the backdrop of continuing global economic uncertainty and generally weak consumer markets, the depth of our customer relationships helped us build on our market leading positions. We held our operating margins and delivered Group EBITDA of US$262m. We also produced another strong cash performance, with operating cash flow similar to last year at US$204m.

The Company continues to follow a consistent strategy which prioritises organic growth through new products, leverages our market positions and engenders close cooperation with our customers. We are making good progress.

R&D is the cornerstone of innovation and the prime driver of our profitability and future growth – it also underpins our development of new products for the electronics market and associated new markets such as LEDs. In 2012, we maintained our R&D investment at approximately 7% of Group revenue, reflecting the quality of our product pipeline and our confidence in the future. As you would expect, this critical activity receives significant focus from the executive team and regular attention from the Board.

We have also seen some interesting applications for existing products entering new markets. For example, our Klebosol® product – a leading multi-purpose colloidal silica – has applications in a wide range of industries outside of electronics. To this end, we are investing in a plant expansion in France, to give us the extra capacity to capture new growth opportunities globally.

As well as developing and protecting our own intellectual property, including taking legal action where necessary, we look to build partnerships with world-leading research institutions to supplement and accelerate our learning and expertise. We bring our product and market application knowledge to the table; they bring their specialised research capabilities. Our collaboration with William Marsh Rice University in Texas is a prime example of this. In November 2012, we announced that we had entered into licensing and sponsored research agreements with them in the field of graphene nanoribbons – a material that has interesting potential applications in a number of electronic and advanced optical devices.

During 2012, we completed the investment in our expanded facility in Taiwan, which has now opened, and in South Korea, which will open later this year. We also successfully integrated last year's strategically important acquisition from Clariant in India, which gives us a platform for sales growth in new markets. This business is small but in 2012 it delivered strong growth. Whilst we continue to explore potential acquisitions, we are clear that any transaction must complement our existing activities and add significant value in the longer-term.

Towards the end of the year, we successfully completed a Group debt refinancing of approximately US$500m which, combined with our strong cash generation and further reduction in net debt, puts us in a good and flexible position for the future. As our balance sheet continues to strengthen, we will monitor the strategic needs of the business alongside the options available for maximising long term shareholder value.

### Dividends

The Board is pleased to recommend a final dividend of 9.1 cents per Ordinary share, bringing the total for the year to 13.1 cents. This is a 7% increase over last year, reflecting our progressive dividend policy. Subject to shareholders' approval, the final dividend will be paid on 3 May to shareholders registered at the close of business on 15 March 2013.

### Board

As a mainly Asian-based business, we were delighted that Ms Philana Poon joined the Board as an independent Non-Executive Director in June. Philana brings with her a wealth of business experience in Asia, having advised boards extensively on commercial, risk and transaction issues. She also has more than 14 years' experience in the technology and telecommunications industries.

Adrian Whitfield stepped down as a Non-Executive Director in May to pursue other interests and we thank him for his contribution.

### Corporate Governance

During 2012, we complied with the UK Corporate Governance Code, with the exception of my ongoing Chairmanship of the Remuneration Committee. In my recent round of discussions with shareholders, this matter was not seen to be an issue.

**4.0 cents**
Interim dividend

**9.1 cents**
Final dividend

**13.1 cents**
Total dividend
↗7%

"In recent discussions with major shareholders, I was pleased to find a growing respect for the Company with investors increasingly confident in the executive leadership team and trusting the Company to deliver on its commitments.

John Whybrow
Chairman

In the second half of the year we undertook our first full performance evaluation of the Board, its Committees and individual Directors which covered structure, operations, processes, efficiency and contributions. The evaluation confirmed that there exists a high level of respect between the Directors who work well together, and an acknowledgement that the Board has in place a set of well-functioning processes. One or two areas of improvement were identified and are being acted upon, mainly around the need to drive the agenda on succession planning for senior management and how we can optimise the effectiveness of the Board's time during the periods we are together.

### Shareholding structure and share price performance

AZ completed its transition to a high quality institutional investor base when our original private equity partners sold their remaining holdings in March 2012, and we have continued an active dialogue with our institutional investors over the year. In addition to the executives' usual programme of investor road shows and events, we held a Capital Markets Day in September which provided a real insight into our business and its growth drivers. In the final quarter, I also met personally with seven of our top shareholders, representing some 35% of our shareholder base, and was pleased to find a growing respect for the Company with investors increasingly confident in the executive leadership team and trusting the Company to deliver on its commitments.

Our investors' confidence in the business was also reflected in a strong share price performance during the year. Overall, AZ's shares have performed well since IPO in November 2010, delivering a total shareholder return of 51% to the end of 2012, compared with 21% for the FTSE 250.

### Organisational and senior management changes

Our organisational structure has continued to evolve. We have moved the business from being managed geographically to being managed and accountable globally, along international business lines. This structure revolves around our two main divisions, IC Materials and Optronics, with the result that our Printing and Other Division was absorbed into the IC Materials Division on 1 January 2013 and will no longer be reported as a separate segment.

The change in structure was also reflected in movements among our senior management team. Mike Douglas, who has made an enormous contribution to the Company over several years, retired as Managing Director of our IC Materials Division, with Rico Wiedenbruch moving from Managing Director of the Optronics Division to replace him. Rico's former role in Optronics has been filled by Anand Nambiar, who was previously Head of Group Operations.

### People

AZ has an experienced and very capable workforce which works with great enthusiasm and commitment across the world. Our processes, customer care and results continue to improve and once again our people have helped AZ to deliver a strong underlying performance. I would like to thank everyone for their hard work and dedication throughout the year.

### Forward look

As we enter the next stage of our development, the longer-term trends for our business are favourable. We are confident of exploiting the opportunities which exist and delivering sustainable growth for shareholders.

### AZ – a strong and growing business

- **We are a critical supplier to the world's major electronics manufacturers, with our unique Asian footprint putting us close to their operations**
- **Our selected niche markets enjoy strong structural growth drivers**
- **Our deep customer relationships allow us to focus our R&D on their needs, helping us to innovate and bring new products to market ahead of our competitors**
- **Our ability to deliver new products and develop new markets contributes to resilient margins**
- **Our capital-light business results in strong cash generation, allowing us to invest in our future**

See Strategy & KPIs: pages 08 to 11

See Board of Directors: pages 46 to 47

See Corporate Governance Report: pages 53 to 59

Our business
## Chief Executive's report

# The Group delivered a strong underlying financial and operating performance and remains committed to investing in its business and technologies

### 2012 Performance highlights

- Solid performance in 2012, in line with our expectations
- Outperformed underlying markets in IC Niche and achieved strong growth in Optronics
- Continued to invest in essential building blocks of the business – people, products and processes
- Continued strong cash conversion and strengthening of the balance sheet
- Fundamentals of AZ's business remain strong

See Strategy and KPIs: pages 08 to 11

See Forward Momentum: pages 12 to 25

See Operating and Financial Reviews: pages 26 to 34

AZ delivered a solid performance in 2012. We continued to invest in our business, giving us a strong platform for growth as well as a real sense of excitement about our future.

AZ's business is ultimately driven by the continued revolution in consumer electronics. Devices that were barely imagined a decade ago – from smartphones and tablets to high brightness TVs – are now commonplace. The pace of change shows few signs of slowing, with new interactive and powerful technologies on the horizon and booming consumer demand in all emerging markets.

These compelling trends keep us focused on our customers' roadmaps for technological and economic development, which in turn require us to continually invest in the essential building blocks of our business – people, products and processes. These investments demonstrate confidence in our markets' long term growth potential and reinforce our sustainable business model, which is described on page 16.

### A solid financial performance

AZ's performance in 2012 was in line with our expectations. While IC Materials saw some demand variations from quarter-to-quarter, its market was generally subdued due to ongoing macroeconomic uncertainty and some supply imbalances at our customers. As a result, growth in wafer starts – a fundamental demand driver for the IC Materials business – was muted and some customers modestly reduced wafer capacity in the second half. The Optronics business grew more strongly as the year unfolded, driven by consumers' appetite for mobile display technologies. In FPD Photoresist, the Group extended its market position in Taiwan and Japan through significant customer wins as we once again leveraged our technology advantages, supply chain security, product quality and reliable order execution.

Group revenue for the year was US$793.9m (2011: US$791.8m), representing a solid trading performance in this challenging economic environment. Group EBITDA[1] was also at a similar level to the previous year, at US$262.4m (2011: US$261.0m). The Group EBITDA margin was therefore broadly unchanged at 33.1% (2011: 33.0%). Currency translation reduced revenue by US$9.7m and EBITDA by US$0.1m. At constant currencies[1], revenue was up by 2% and EBITDA increased by 1%.

During the year we invested US$55.8m in R&D activities (2011: US$54.0m), representing 7.0% of Group revenue (2011: 6.8%). Our R&D expenditure remains highly customer-oriented, with a particular focus on materials that support the evolution of "leading-edge" semiconductor and display technologies, and where we can command market leadership positions. In IC Materials, our R&D concentrated on new and extended IC Niche products. In Optronics, our R&D expenditure focused on new applications for our proprietary silicon chemistry.

"

I am pleased with the continued market penetration of our products, particularly in IC Niche where we continue to grow ahead of the market, and also in Optronics where we continue to make good progress.

Geoff Wild
Chief Executive Officer

Capital expenditure during the year was US$50.7m (2011: US$50.5m), representing 6.4% of Group revenue (2011: 6.4%). The majority of this investment was in equipment used in R&D and quality assurance processes, and the expansion of our Taiwanese and Korean facilities, which will provide customers in those areas with shorter and more secure supply chains as well as enhanced local support.

On a like-for-like basis, the Group's reported profit after tax in 2012 of US$82.9m was 2% higher than the previous year (2011: US$81.5m), adjusting for a one-off tax credit of US$15.0m that was included in the previous year's earnings. Reported profit after tax in 2011 was US$96.5m.

After adding back amortisation net of related tax, Adjusted Earnings per Share[1] were 35.4 cents (2011: 35.2 cents). The Board is recommending a final dividend of 9.1 cents per Ordinary share (2011: 8.5 cents), resulting in a total dividend of 13.1 cents per Ordinary share for the year (2011: 12.3 cents).

AZ's cash flow remained strong. In 2012, we generated Operating Cash Flow[1] of US$204.4m (2011: US$206.3m), representing a conversion of 78% of EBITDA into cash (2011: 79%). This underpins our ability to invest in the business to drive growth and pay dividends to shareholders, while further reducing net debt, which stood at US$289.4m at 31 December 2012 (2011: US$343.4m), or 1.1 times EBITDA (2011: 1.3 times). We refinanced our Group debt in December 2012, giving us new 4.5-year facilities totalling approximately US$500m.

## Progress across our core businesses

IC Materials is our largest division by revenue, representing 68% of Group revenue in 2012 (2011: 69%). Revenue for the year was US$537.2m (2011: US$545.1m), down by 1% (flat at constant currencies[1]).

The IC Materials Division contains two product sub-groups, IC Niche and IC Conventional. IC Niche revenue grew by 1% to US$356.0m (2011: US$352.1m), or 3% at constant currencies[1], ahead of the underlying 2% reduction in industry memory wafer starts. This was primarily due to demand for yield enhancement IC Niche materials, particularly from customers in the IC foundry segment, and sales of AZ's Klebosol® colloidal silica materials which continued to progress well. As expected, revenues from AZ's Spinfil® dielectric materials were impacted by dual-sourcing by certain customers, as well as anticipated dispense-volume reductions by our customers. As previously reported, the Group filed a lawsuit against a Korean competitor in March 2012, alleging infringement of certain intellectual property rights relating to our dielectric technology. The lawsuit is ongoing and we will provide a further update when the verdict is known. We will continue to vigorously defend our valuable intellectual property portfolio as and when required.

IC Conventional revenues were US$181.2m (2011: US$193.0m), a decrease of 6%, or 5% at constant currencies. Although this decrease was broadly in line with the reduction in industry wafer starts, it principally reflects AZ's strategy of proactively ceding low value-added edge bead remover ("EBR") business which amounted to a negative effect of around US$18m in 2012.

The Optronics Division generated 30% of Group revenue in 2012 (2011: 28%). Revenue for 2012 was US$236.9m (2011: US$224.1m), an increase of 6% at both actual and constant currencies. Our FPD Photoresist products have strong market positions and generated revenue of US$188.0m, up 6% (2011: US$177.2m), or 7% at constant currencies. While first quarter conditions were difficult, demand picked up through the year and benefited in the second half from improved conditions in the global flat panel industry and customer wins in Taiwan and Japan. Optronics Other revenue increased to US$48.9m (2011: US$46.9m), up 4% at both actual and constant currencies. Our performance in this area was driven by good progress in our Light & Energy business, offset by reduced year-on-year sales of low value-added EBR and ancillary business.

Revenues in the Printing and Other Division were down by 12% in 2012, from US$22.6m to US$19.8m. This represented a constant currency decline of 5%. From 1 January 2013, Printing has been included within our IC Materials Division (under IC Conventional), so it is aligned to and reflects our new management structure.

## Continued confidence in the long term

Our markets have exciting long term potential because our customers face complex technology and production challenges and look to us for solutions. AZ, with its strong market positions, worldwide presence, and customer-focused R&D, is ideally placed to benefit. In many cases, our capabilities will enable us to outperform underlying growth of the substrates on which our chemicals are dispensed.

In the IC industry, it is increasingly challenging for our customers to design and manufacture advanced integrated circuits because the costs and complexity involved in achieving smaller pattern sizes on chips is rising substantially. It is reported, for example, that in moving to the 20 nanometre ("nm") technology node from the 28nm node, our customers will incur twice the R&D cost and see an increase in the number of process steps per layer of over 80%. This is pushing our customers to look for novel ways to reduce their development and manufacturing costs while maintaining their yields and servicing industry demand. Increasingly, it is materials-based solutions that enable customers to strike that balance. Similarly in Optronics, advanced materials can help to solve our customers' technological, cost and yield issues, which is especially important in an industry where the affordability and "form factors" of flat panel displays are critical to their success.

We continue to position the business to capture the emerging opportunities available to us. Since AZ became a public company in 2010, we have followed a consistent strategy that leads us to invest in innovation carefully but confidently through our people, products and processes.

Our business
## Chief Executive's report continued

**5 % points**
Revenue outperformance by IC Niche versus memory wafer growth in 2012

**82%**
The proportion of total revenue from products where AZ holds a No.1 or No. 2 position in its chosen niche markets

**6%**
Revenue growth in Optronics year-on-year

### Outstanding people
AZ employs some of the best people in our industry. They are highly educated, with long service records and a wealth of experience. They nurture our customer relationships and are the key to innovation. Our headcount increased by 32 to 1,092 employees as at the end of the year, reflecting our confidence and investment in the future.

During the year, we appointed our first Director of Human Resources, giving us a renewed focus for developing and retaining our people. We also spent more time identifying and nurturing our talent, including the recent senior management changes, which have allowed people to move through the organisation and opened up new opportunities. Mike Douglas retired as Managing Director of our IC Materials Division at the end of 2012 and was succeeded by Rico Wiedenbruch, who was Managing Director of Optronics. Anand Nambiar, who had been our Head of Group Operations since July 2010, has taken over Rico's former role.

Our people responded with great energy to the aftermath of Hurricane Sandy on the East Coast of the United States. Through their dedication, we successfully activated our business continuity plan and continued to serve our customers without interruption in difficult circumstances.

I would like to thank all our employees worldwide for their hard work throughout the year. With their continued support and dedication, I am confident we will achieve our goals.

### Exciting products
With such a broad range of growth opportunities, we focus our development efforts on products that are truly niche and high value-add for our customers. Areas with significant potential include materials for ever more powerful memory and logic chips (sub-20 nanometre ICs), advanced displays, LED lighting and certain non-electronic applications.

Our world class silicon chemistry capabilities in IC Materials are now also starting to benefit our Optronics business. Our expertise in silazanes and siloxanes, which take advantage of unique optical dielectric and permeability properties, are helping us to develop a platform of advanced materials that have a diverse range of applications, including OLED displays, flexible displays, advanced LCD displays and high brightness LED lighting.

We continue to augment our product development strategy through strategic alliances. During the year, we entered into licensing and sponsored research agreements with William Marsh Rice University in the field of graphene nanoribbons, which have exciting potential applications in a wide range of electronic and advanced optical devices. This augments our platform for long term growth.

### Excellence in everything we do
AZ is dedicated to outstanding local customer supply and support. In 2012, we completed the expansion of our Korean and Taiwanese plants. We also announced investment in our colloidal silica capacity at our Lamotte facility in France, allowing us to meet growing demand and to enhance our position in niche growth markets within certain non-electronic industries.

During the year, we continued our efforts to maintain a world class supply chain. We also remained focused on our responsibilities as a global business. This includes our responsibilities to the environment and our local communities; employee well-being, health and safety; excellence in production, quality assurance and control; and continuous operational improvement.

Although the near term outlook remains uncertain, the fundamental long term demand drivers for integrated circuits and flat panel displays remain strong. We are continuing to position AZ to capture these opportunities, by ensuring that our people, processes and products can provide world class and critical enabling materials to our customers, who will in turn shape the evolution of leading-edge electronics.

### Outlook
We expect 2013 to be a year in which revenues and profits will show positive momentum, with industry analysts and our discussions with customers suggesting a stronger environment for growth during the second half of the year. There are still uncertainties in the near term macroeconomic outlook that continue to impact consumer markets and many of our customers. We nevertheless expect the first half to show modest year-on-year growth.

We remain committed to investing in our business and technologies, developing leadership positions and delivering growth in line with our long term guidance in order to provide attractive long term returns to shareholders.

Note:
1. See definitions in Financial Review on page 30

# Critical chemistry
# Specialty materials


Our specialty is just that – specialty materials which have, in their form and function, properties which enable our customers to do some remarkable things. Like the spin-on dielectric which is used in the majority of memory chips made today, or the advanced photoresist system which is used to make the new generation of 3D televisions, or the anti-reflective coatings used to make the "brains" behind the popular tablet PCs.

The continuous drive to make faster, more capable and yet more cost-effective products, is pushing the electronics industry to the edge of its technical capabilities. AZ's expertise in developing new, "specialty" high performance materials for these mission critical applications is helping the industry deliver the next-generation of consumer electronic devices.

Our business
# Our strategy

Our vision sees AZ continue its development as one of the leading and most respected advanced chemical materials companies in the world. We have a clear strategy for achieving this vision and the Group is well positioned to take advantage of future growth opportunities.

| Our strategic priorities | Description | Risk |
|---|---|---|
| 1 **Focus** on the timely development and commercialisation of new products | We have a predominantly organic growth strategy, based on delivering innovation to our customers. This helps them to meet their technology roadmaps and in turn drives structural growth in the electronics industry. | Customers will only qualify products that meet their timelines for a target manufacturing "node" or display device. Failure to meet agreed levels of quality may jeopardise new business. |
| 2 **Develop** niche markets where AZ can secure a leading position | We continue to target opportunities where we can hold or develop a No.1 or No.2 market position, with products that add significant value for our customers. | Attractive market segments can induce increased competition and pricing pressure. |
| 3 **Extend** and develop opportunities utilising AZ's core expertise | We have competencies in photolithography, silicon-technology, specialist polymer chemistry, thin films and coatings, manufacturing at ultra-high-purity, and working within a certified supply chain. We look to build on these to develop new products and market opportunities from our global manufacturing base. | Customers tend to favour existing products and processes, so market acceptance of completely new technological approaches is uncertain. Competitors may also target attractive opportunities. |
| 4 **Manage** our human resources to develop organisational capabilities and talent | We align individual goals and objectives to our corporate strategies and priorities. We develop the skills of our team members through internal and external initiatives, and identify and nurture talent. We operate attractive incentive programmes to motivate, reward and retain key talent. | As a niche high-technology business, we employ many specialists from a limited talent pool. We need an appropriate number of qualified individuals and our inability to retain or recruit the right people could jeopardise our plans. |
| 5 **Monitor** the M&A landscape and be ready to act should appropriate opportunities develop | Our strategy is based on organic growth but we remain alert to opportunities that can augment our strategy, or bring new technology that can add value by bolstering our core competencies. | There is no guarantee that we will make complementary acquisitions, but those we do must be fully integrated with the business in order to extract the desired synergies and deliver value. |

**Driving profitable growth and creating value**

# Our strategic priorities are supported by divisional-level drivers and forward focus

See KPIs: pages 10 to 11

## IC Materials

| Key drivers | 2012 progress | Forward focus |
|---|---|---|
| Further develop yield enhancement business with water-based products | • Achieved attractive aggregate revenue growth for this product set<br>• Opened a US$5m TARC plant in Taiwan providing local supply to key customers<br>• Significantly expanded our Shrink business at a major memory manufacturer<br>• Secured process of record for our rinse material at another major memory player | • Extend and align current business to the imminent change in technology advancement<br>• Develop new customers |
| Protect and grow spin-on dielectrics | • Made good progress on process extensions and refinements<br>• Commissioned new manufacturing expansion in South Korea<br>• Filed a patent infringement action in South Korea against competitor for making and selling PHPS material | • Continue development of materials for use in leading-edge manufacturing nodes in memory and logic |
| Develop a range of lithographic extensions for advanced patterning | • Made good progress for directed self-assembly material set at *imec*, and sampling multiple memory and advanced logic/foundry customers<br>• Sampled major customers with a number of materials for extreme ultra-violet lithography and negative-tone developer processes | • Drive R&D to address a variety of potential future customer processes |
| Develop non-electronic applications for our colloidal silica business | • Established good growth opportunities in Asia outside the electronics industry<br>• Commissioned new manufacturing expansion in France | • Manage new customer relationships |
| Drive additional IC Conventional business in advanced packaging | • Increased sales to the packaging segment, with a strong performance in thick-film resists and ancillaries | • Continue product development work |

## Optronics

| Key drivers | 2012 progress | Forward focus |
|---|---|---|
| Leverage market leading position | • Won new business from a major competitor, utilising our strong supply chain and technical capabilities to support customers through an upstream supply disruption | • Continue to support customers through our unique position as the only photoresist manufacturer present in each of the major display manufacturing markets |
| Diversify product lines with new Si-Tech materials | • Successfully integrated the 2011 acquisition of the polysilazanes coatings and resin business in India<br>• Achieved commercial targets for a number of Si-Tech materials<br>• Secured orders for new materials | • Penetrate and support customers pending readiness to ramp end-devices<br>• Continue work on applications in Light & Energy to add further qualifications |
| Invest in new technology for future growth – partnerships and/or M&A | • Signed agreements with William Marsh Rice University to access and research graphene nanoribbons<br>• Worked in partnership with Orthogonal Inc. on materials for flexible substrates-related technology | • Continue development and commercialisation efforts<br>• Maximise opportunities within each project scope<br>• Target efforts on one or two additional areas for further development |

# Our business
# Key performance indicators (KPIs)

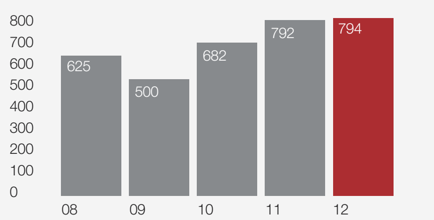
Setting clear targets and applying measurable performance indicators is an essential discipline which helps us monitor progress towards achieving our strategy.

The senior leadership teams regularly review KPIs in managing the business and measuring our performance against targets.

See Financial Review: pages 30 to 34

## Financial KPIs

### Revenue (US$m)



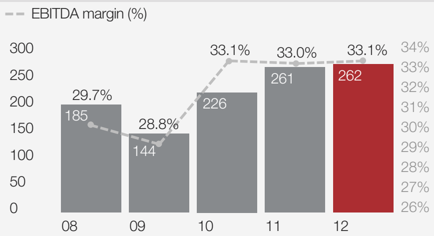

### Relevance to strategy

Revenue is an important indicator of customer demand and our activity levels. It applies to all areas of our strategic plan and is assessed in relation to each priority. Revenue records are compared to external measures and forecasts of growth and determine the market positioning of our products, customer and geographical trends and the relative strength of key product areas.

### Performance

Group revenue for the year was US$793.9m (2011: US$791.8m), representing a solid trading performance in a challenging global economic environment. The Group maintained its strategic focus on market-leading and innovative niche products (IC Niche and FPD Photoresist), which together represented 69% of the Group's revenue (2011: 67%).

### EBITDA and EBITDA margin[1] (US$m)



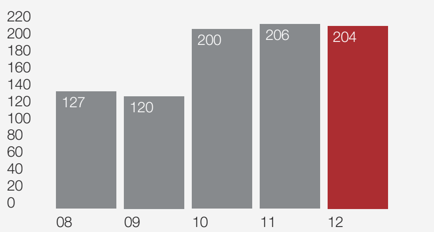

### Relevance to strategy

EBITDA[1] and EBITDA margin[1] are measures that are used at all levels of the business to target and monitor operating performance. Realisation of planned EBITDA is the primary source of cash for the Group, and therefore is central to our strategy.

### Performance

EBITDA for the IC Materials Division of US$215.8m was 2% lower than 2011 primarily as a result of a 1% reduction in revenues. The Optronics Division EBITDA accounted for US$67.9m (2011: US$62.8m), an increase of 8%, primarily driven by a 6% increase in revenues.

### Operating cash flow[2] (US$m)



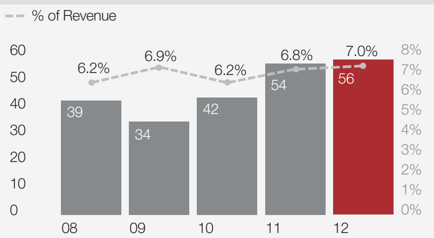

### Relevance to strategy

Operating cash flow[2] is a key indicator of the amount of free cash flow generated by AZ's business before funding and tax costs, and is used to monitor the conversion of profits to cash. This measure is uniformly used across the Group and ensures attentiveness to efficient working capital management. Cash flow is central to our strategy, helping facilitate repayments of debt, future investments and distributions to shareholders.

### Performance

In 2012, the conversion of EBITDA into operating cash flow was 78% (2011: 79%). The reduction in the year-on-year cash generation is partly attributable to the increased investment in R&D. Strong cash generation continues to be a key focus for the Group.

### R&D expenditure (US$m)



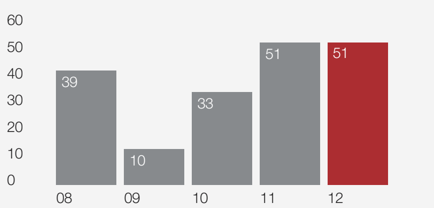

### Relevance to strategy

R&D expenditure is a measure of investment in the growth of our business. Expenditure is analysed against our priority to maintain our leading-edge R&D capability. This priority is also monitored against measurable revenue indicators.

### Performance

During the year, US$55.8m was spent on R&D. Of this, US$43.4m was in the IC Materials Division, representing 8.1% of the division's revenues. R&D expenditure for Optronics was US$11.6m, representing 4.9% of division's revenues.

### Capital expenditure (US$m)




### Relevance to strategy

Capital expenditure is monitored to ensure funds are allocated and invested to achieve our strategic priorities. AZ serves industries that are characterised by fast changing technology and structural growth. As such, we invest in the equipment needed to develop new products and in our production capacity and equipment so we can keep pace with our customers' needs. These investments are vital to sustain our market-leading positions.

### Performance

Capital expenditure during the year was US$50.7m (2011: US$50.5m), representing 6.4% of revenue (2011: 6.4%). The majority of this investment was in equipment used in R&D and quality assurance processes, and the expansion of our Taiwanese and Korean facilities which will provide customers in those areas with shorter and more secure supply chains as well as enhanced local support.

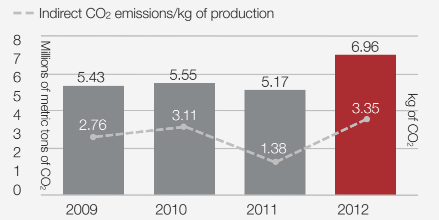
In addition to the financial metrics set out opposite, the Group also monitors certain non-financial KPIs relating to our product quality and environmental, health and safety targets.

Further details, including performance against these targets, can be found in the Corporate Sustainability and Responsibility Review on pages 38 to 45.

See CSR: pages 38 to 45

## Non-financial KPIs

### $CO_2$ emissions (indirect)



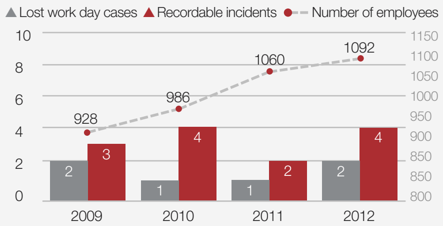

### Relevance to environment

We encourage the preservation of natural resources and the environment through our conservative use of energy.

### Performance

The increase in indirect $CO_2$ emissions in the year was directly related to increased energy usage. This was primarily driven by the commissioning of the plant expansions in South Korea and Taiwan and a change to the product mix whereby more energy consuming products were produced.

### Lost work day cases and incident rate




### Relevance to health and safety

Maintaining the health and safety of our employees and visitors to our premises is vital to maintaining our status as supplier and employer of choice. Our target is zero lost working day cases and recordable incidents.

### Performance

Unfortunately in 2012, we suffered four recordable incidents, of which two resulted in lost working days. The incident rate is disappointing and has been addressed through increased training, awareness and communication emphasising the importance the Group places on providing a safe working environment at all of its premises.

### Quality and ontime delivery

| | 2009 | 2010 | 2011 | **2012** |
|---|---|---|---|---|
| Complaints relating to the quality of our products | 0.2% | 0.2% | 0.2% | **0.2%** |
| Ontime delivery rate | 99.5% | 99.8% | 99.8% | **99.7%** |

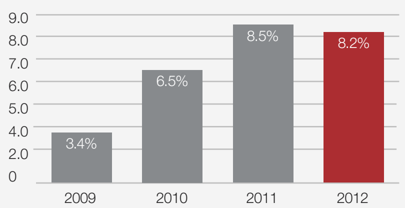
### Relevance to customers

Our customers demand high levels of product quality and prompt delivery, resulting in these statistics being critical to maintaining a sustainable business. Across the Group, we share information, expertise and best practice to ensure consistent quality and service for all our customers.

### Performance

During the year, we once again maintained our excellent quality and ontime delivery performance.

### Employee attrition rate (voluntary)




### Relevance to employees

Employees are a key part of our business and we invest considerable amounts of time and money in recruiting, educating and developing them. To ensure the best return on this investment, we seek to retain our most valued employees for as long as possible.

### Performance

In 2012, the Group's voluntary employee turnover reduced to 8.2% (2011: 8.5%).

Note:

**EBITDA**[1] is defined as operating profit before depreciation and amortisation of intangible assets. For the years 2008 to 2010 EBITDA was further adjusted for exceptional items, and monitoring fees. There were no exceptional items or monitoring fees impacting EBITDA during the 2011 and 2012 financial years. The requirement to pay monitoring fees to AZ's previous shareholders ceased on 3 November 2010. **EBITDA margin** is calculated by dividing EBITDA by revenue.

**Operating Cash Flow**[2] is defined as EBITDA with charges in relation to share-based payments added back, less any changes in working capital (excluding those relating to transaction costs), less net cash payments in relation to capital expenditure and, in respect of 2012, after adding back charges relating to share-based payments.

# Forward momentum


In today's fast changing world, demand for our products is driven by powerful trends – from the proliferation of electronic devices and their increased speed, capacity and functionality, to economic and population growth in major emerging markets.

# AZ is well positioned at the juncture of powerful global mega-trends

AZ's growth is directly linked to demand for consumer electronics. Two powerful trends are driving this demand around the world and these look set to continue for the medium to long term.

First, technological changes are leading to smaller, more powerful and more desirable devices with increasing functionality. Advanced chemicals are ever more important in enabling manufacturers to create these devices.

Second, economic growth in developing markets, combined with the scaling-benefits of Moore's Law, are resulting in the emergence of a vast new group of consumers, with a corresponding appetite for the latest technology and the digitisation of virtually all forms of data. Rising populations in these markets are reinforcing this trend. It is estimated, for example, that more than one billion smart phones will be sold in 2013 alone.

## Technological growth drivers

The electronics industry is fundamentally changing our world. The ability to make microprocessors and memory smaller while increasing their power and capacity is a key enabler of this change, and one that in part depends on advances in specialty chemicals. The result is that manufacturers are making increasing numbers of smaller and more complex devices at a lower unit cost, resulting in cheaper semiconductors, which in turn stimulates further demand and more applications.

Advances in consumer electronics have created today's interconnected lifestyles, which are driving further demand as the devices become integral to consumers' lives. The software industry has responded by developing applications that take advantage of the processing power available, making devices more useful – and hence more attractive – to consumers. Major new applications continue to be developed that consume processing power and memory.

Enhancements to screens are another key technological driver, with more and more devices featuring touch panels, making the interface easier and more intuitive to use. Televisions also continue to advance, with ever greater definition. At the same time, the desire to save energy is producing a high growth market for LED lighting.

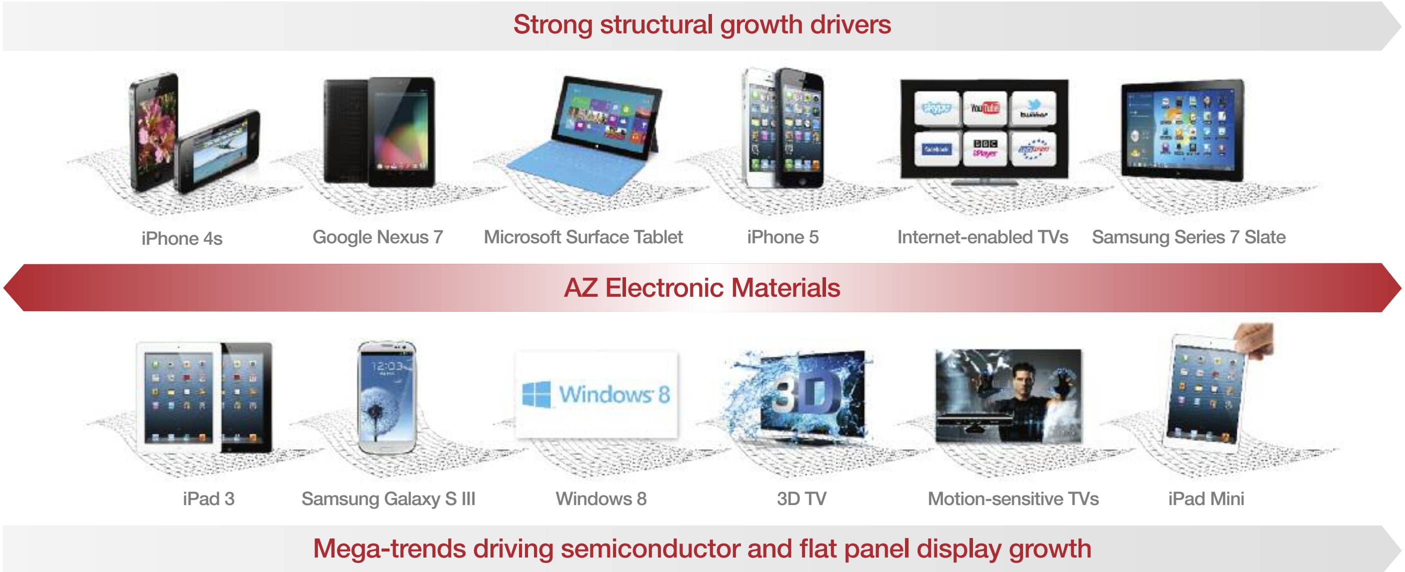
New entrants to the hardware markets – including companies that have previously limited themselves to providing content for devices – are also creating new types of consumer electronics such as advanced e-readers and cheaper tablets. These devices are stimulating demand even in relatively saturated developed economies.

## Economic and demographic growth drivers

Economic growth in emerging markets has been a significant driver of demand for electronics. This is especially true in the BRIC countries (Brazil, Russia, India and China), which between them account for some 40% of the world's population, and which have seen rapid increases in spending by their middle classes.

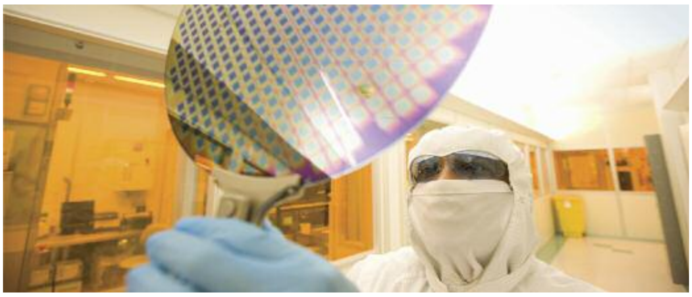
These trends have further to go. China and India still have relatively small middle classes (around 20% and 5% of their respective populations), whose spending today is also still comparatively low. Even at its current lower economic growth rate, China's middle class is expected to spend three times more in 2020 than in 2010, while in less than ten years' time, Asia Pacific could account for more than half the world's middle class, compared with just one quarter today.

With rising disposable incomes, consumers in emerging markets have started to see many devices as "must haves" rather than luxuries. Individuals increasingly own multiple devices, from smartphones to tablets to PCs and televisions. The relatively low cost of devices has enabled people to perform technological leaps, allowing them to have the latest technology without following the pathway trodden by the developed world.



Forward momentum continued

# Driving growth opportunities in IC Materials and Optronics



### Growth drivers in IC Materials

The growth in demand for semiconductors is the primary growth driver for IC Materials. Semiconductor production is expected to continue to grow over the next few years at historically healthy rates, as the demand for consumer electronic devices accelerates. Devices such as smartphones, tablets and e-readers will all contribute to this growth, but we will also see growth in other areas such as automotive, medical and industrial applications.

Semiconductors are mostly based on silicon wafers. The number of wafer starts is therefore a useful indicator of demand for the advanced chemicals that are used in producing semiconductors. However, the demand for advanced chemicals should exceed wafer starts, as semiconductor manufacturers continue the process of miniaturisation, increased functionality and greater processing power which is required for each new generation of devices.

### Technological developments

Further miniaturisation, in line with Moore's Law, will require further advancements in specialty chemicals. Semiconductors are created in patterned layers, which ultimately form a complete integrated circuit. As the number of layers on a semiconductor rises, so can the demand for the latest advanced chemicals. Products such as anti-reflective coatings to improve pattern uniformity and fidelity, specialty rinses to reduce pattern collapse and defects, and chemical shrink materials for controlled reduction of feature sizes, are essential for enabling die size reductions and enhancing manufacturing yields.

One new material innovation is negative-tone development ("NTD"), in which the light-sensitive material used to create patterns on the semiconductor (known as the photoresist) is exposed to light and the organic solvent used for development removes the unexposed material, effectively reversing the imaging. This provides finer resolution capabilities and process window performance. The use of NTD in manufacturing is aided by new anti-collapse rinse agents to gain the process window improvements needed to deliver cost-of-ownership benefits. Chemical shrink materials are also finding use in NTD flows to further push resolution, enabling even finer feature patterning with installed lithographic tool sets.

With smaller and smaller patterns needed, new patterning techniques such as extreme ultra-violet ("EUV") lithography and directed self-assembly ("DSA") are likely to be required. EUV will require the use of new coating and protection materials, while DSA – which may offer a very significant reduction in cost-of-ownership compared with EUV – requires entirely new materials which are being pioneered by AZ.

Memory chips continue to advance. Smaller feature sizes are being developed allowing higher capacity in a smaller space, as well as lower energy use. 3D NAND (a type of flash memory) is being developed for the future, where memory cells will be stacked on top of each other. New chemical materials products and processes will be needed for these memory chips, again driving demand for companies such as AZ.

## The criticality of AZ:

### Critical today

**Foundation for Success, such as:**

**Advanced chemistry and materials science**
AZ's core capabilities are derived from our deep knowledge of chemistry and materials, and our ability to apply it. Our strong platforms in light-sensitive materials and Si-Tech polymers provide pathways to high performance formulations.

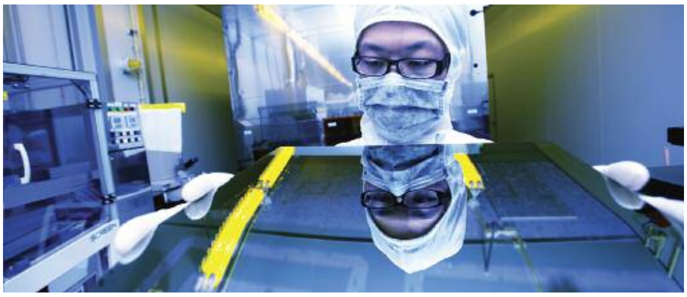
**Performance**
Exciting our customers requires us to deliver the chemistry and materials solutions they need, time and again, in this technology cycle and beyond. Our robust development process provides that technical strength, as we have demonstrated in the semiconductor and display industries for decades.

**Partnerships**
The best solutions come from collaborations that join different competencies, with the whole being smarter and faster than the parts. Partnering has always been at the forefront of AZ's business philosophy.

**Innovation**
Thinking "outside the box" often leads to breakthroughs in materials and processes. AZ repeatedly looks beyond the traditional solutions to customer problems, to invent brand new ways to make things work.

"In a world where it increasingly seems like everything is going digital, the long term trends in both the IC Materials and Optronics markets are exciting. We believe that technological developments and consumer demand for electronics will ensure a bright future for both parts of our business.

Geoff Wild
Chief Executive Officer



### Growth drivers in Optronics

Demand in Optronics is being driven by three primary trends: the economic and demographic shifts in emerging markets discussed on page 13, technological advancements, and new business models for technology companies. There are also compelling growth trends in the LED lighting market.

### Technological developments

The general move towards screens with higher resolution, brightness and frame-refresh rates is leading to further penetration of low temperature poly-silicon ("LTPS") technology for small to medium-sized panels, and indium gallium zinc oxide ("IGZO") technology for medium to large panels. Both technologies require advanced photoresists and more layers, increasing the consumption of photoresist for a given area of panel. The expected launch of ultra-high definition television in 2013 may also create demand for silicon-based chemicals used in planarisation and dielectric insulation applications. These technological advances will be beneficial for technically strong companies such as AZ, as they will potentially widen the gap with lower-tech suppliers.

## Critical tomorrow

### New Pathways for Next-Generation Technologies, such as:

**Organic Light-Emitting Diodes (OLEDs)**
AZ is developing products for future OLED displays. OLEDs are solid-state devices composed of thin films of organic molecules that emit light when current is applied. OLEDs can provide brighter, crisper displays and use less power than today's LED or LCD displays.

**High Definition Displays**
Display resolutions are increasing significantly, with improved lithographic patterning approaches and new materials. AZ's industry-leading photoresist technology is providing advance patterning performance for these next-generation processes, improving the sharpness and performance of both large and small displays.

**Extreme Ultra-Violet (EUV) Lithography**
EUV is a next generation lithography technology. It uses an extreme ultra-violet wavelength to image much smaller features than immersion lithography, creating smaller, more powerful transistors which make more powerful chips. AZ is working with numerous industry companies to support the improvement in EUV technology.

**Directed Self-Assembly (DSA)**
AZ is leading the industry in developing materials and processes for DSA, in which block copolymers self-assemble into patterns as small as 13 nanometre, a challenge for even EUV. It is an alternative to quad patterning and EUV, but could also complement the EUV process.

Another important driver of Optronics demand is the development of premium devices which can be positioned above the mass market. These devices may feature high resolution, 3D, internet integration, touch panels, thin form factors, low weights, low energy consumption and panels which are non-breakable or even flexible. Organic LED ("OLED") technology will have a part to play in this.

However, consumers' willingness to pay for these devices will be key, so panel makers will continue to tightly control their costs and the timely introduction of new devices by carefully watching the market. In the meantime, they will work to control yield, as yield loss tends to be a significant cost for them. The introduction of LTPS and IGZO technologies is likely to create a capacity squeeze, encouraging manufacturers to further reduce yield losses. AZ is set to benefit from this trend, with our portfolio of advanced materials and strong customer and technical service.

### New business models for technology companies

As noted on page 13, technology companies are increasingly competing with each other by producing their own devices. Major players such as Amazon, Google and Microsoft, which have traditionally provided content and services, have all entered this arena. In addition, semiconductor makers such as Intel are starting to push directly into the device market.

The existing panel makers who form AZ's customer base will continue to fabricate the devices, benefiting from a flurry of exciting products. This is expected to revive consumer demand in otherwise largely saturated markets.

### Attractive growth in LED lighting

We see substantial growth opportunities in the general lighting market, which is expected to overtake the FPD backlighting market as the largest user of LEDs within a few years. Legislation is an important driver here, pushing the adoption of energy-saving lights to curb increasing electricity demand and reduce carbon dioxide emissions.

There is also a trend towards brighter LEDs, with high brightness and ultra-high brightness LEDs appearing at the premium end of the market. The advanced LEDs which these devices rely on require new enabling materials, including photoresists and Si-Tech materials, which are currently under development. These materials are geared to improving device longevity, heat management and brightness. We also expect to see the emergence of panel-like OLED lighting, which could require novel materials with strong gas and moisture barrier effects.

See Innovation, our passion: pages 18 to 21

Forward momentum continued

# A strong and defendable business model

AZ has a strong and defendable business model – one that creates high barriers to entry, delivers robust margins, is capital-light and strongly cash generative. Our business model is summarised in the diagrams below, which between them create our "virtuous business cycle."

### Market leadership in critical and high value-added niches

AZ is a market leader. In 2012, 82% of our revenue came from products where we have No.1 or No. 2 market positions. More than 2,000 patents protect these positions and we continually add to our valuable intellectual property portfolio through R&D.

### Deep understanding of our customers' technology and production challenges

We have strong relationships with major electronics manufacturers, developed over decades and generations of products. The following factors reinforce these relationships:

- Our customers are capital-intensive. They make significant investments in their production facilities, so they operate them as close to 100% capacity as possible. They therefore look to minimise the risk of disruption to their supply chain.
- Product quality is vital. We place the highest importance on meeting our customers' quality requirements and have a target of "zero complaints". We ensure we buy quality materials through a rigorous supply chain process which includes regular supplier audits. We make substantial investments in our quality control and testing facilities. We also ensure we offer security of supply through our business continuity plans and geographic diversity. AZ has a global presence with a particular focus on Asia, where the majority of our customers are based.
- Our customers certify their supply chains. As product quality is vital, our customers work with certified suppliers they can trust. AZ is therefore subject to stringent qualification and product certification procedures. Once accepted, we become integral to our customers' manufacturing processes, creating substantial barriers to entry and allowing us to benefit from their growth.
- Our products are a small part of their cost. Even though they are critical, our products typically account for a small part of the production costs for IC and FPD manufacturers. Given the risk of business disruption, our customers can have little financial incentive to switch to other suppliers.

### Customer intimacy in R&D

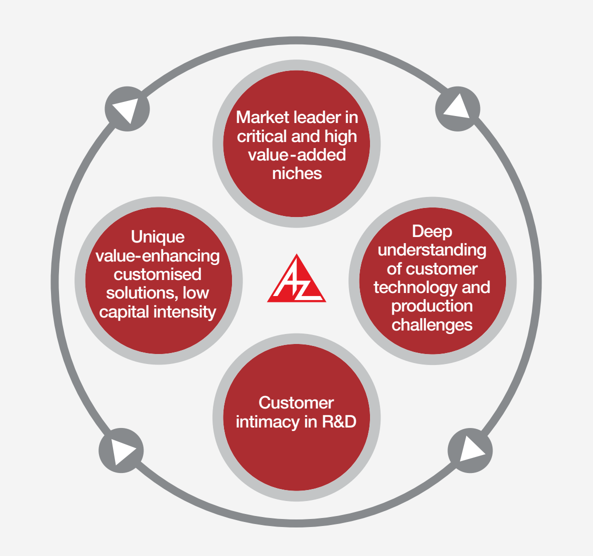
Our customers need to differentiate their products and we support this through innovation. The majority of our R&D stems from customer-initiated projects and we work closely with them to jointly develop specifications. In turn, this helps us stay at the leading-edge of electronic materials development.

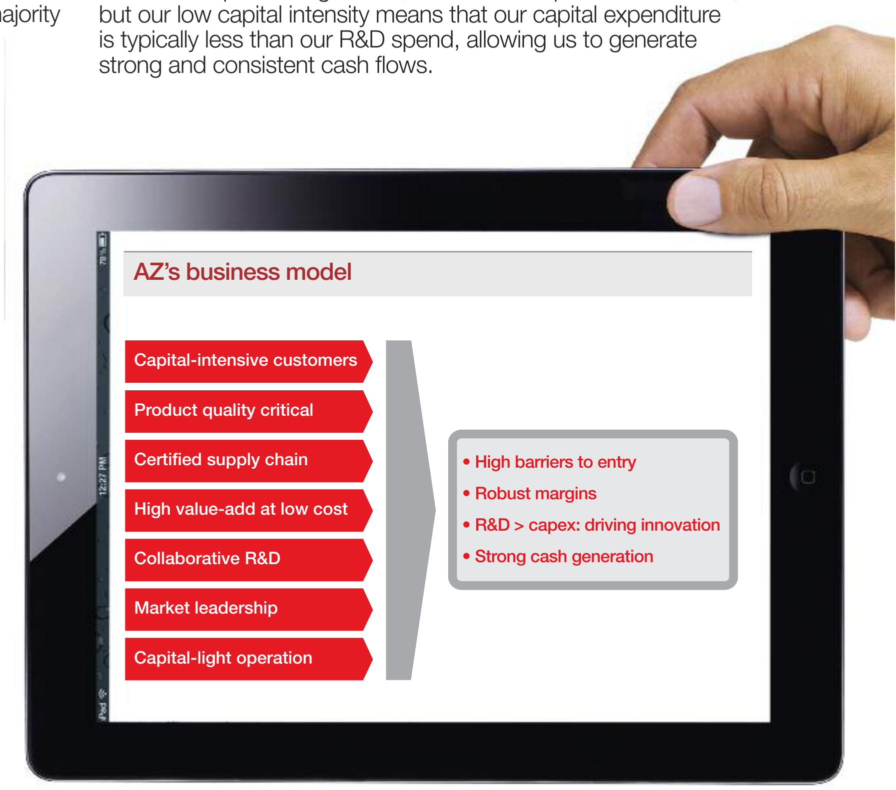
We have localised our R&D activities, with laboratories in France, Germany, Japan, South Korea, Taiwan and the USA. Physical proximity to our customers helps to strengthen our relationships and enhance our understanding of their needs.

### Unique, value enhancing customised solutions, with low capital intensity

Our customer intimacy in R&D ensures that our products are truly "niche" and have significant barriers to entry. The importance of R&D means our spend is significant, at 7% of Group revenue in 2012, but our low capital intensity means that our capital expenditure is typically less than our R&D spend, allowing us to generate strong and consistent cash flows.

### AZ's virtuous business cycle



# A strong platform for growth

AZ is a world leader in advanced specialty chemical materials for the electronics industry. We have a proven track record in successful innovation and in developing high quality products that set new standards and deliver significant value to our customers.

We are well positioned at the juncture of powerful global mega-trends which continue to drive an insatiable appetite in consumer electronics and fast changing technological developments. In turn, these are creating positive long term growth trends in both our IC Materials and Optronics markets.

AZ has exciting growth opportunities in its sight and a strong platform – comprising innovation, people and partnerships – from which to capture them. We continue to invest in our platform to ensure we harness the forward momentum and deliver sustainable growth for our shareholders.

**Our platform for growth:**

**Innovation**, our passion

See pages 18 to 21

**People**, our assets

See pages 22 to 23

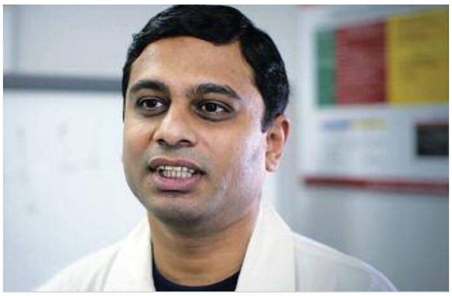
**Partnerships**, our strength

See pages 24 to 25

Forward momentum continued
**A strong platform for growth**

# Innovation, our passion

Innovation is the lifeblood of our business and the ultimate competitive advantage. Our customers' industries are fast moving and technically demanding, so we must generate new materials which are aligned to their evolving needs and enable us to grow our revenue. Our products are vital to our customers' success, so we work closely with them, and others, to develop new products and maximise the effectiveness of our R&D.



# US$55.8m

Invested in R&D activities in 2012

"Customer intimacy, rapid cycles of learning and robust processes to manage our pipeline are key to developing innovative solutions.

Brian Daniels
Global R&D Director

## Big R and Big D

In order to structure, monitor and maximise the effectiveness of our R&D investment, AZ has established the "Big R, Big D" model.

In the initial stages of a project, which we call "Big R", our focus is on research and exploration – basically understanding and developing custom chemistry platforms for the area of interest. The timescales involved are relatively long when compared to the development phase, and it is more important in Big R to be based close to our technology partners and innovators than it is to be near to our customers.

The development stage, which we call "Big D", is an iterative process where success often depends on the number of learning cycles that we can complete in the time available. Here, the focus is on converting the chemistry platform into a product, and then fine tuning and adapting it to specific customer requirements. We do a lot of this work at our R&D centres in Asia since, with some 80% of our revenue derived from that region, it is important to locate programmes near to our customers when a product is in the Big D stage (and nearing market introduction) to allow quick turnarounds.

AZ has six R&D centres of excellence – two focused on Big R in Germany and the USA, with the remaining four in France, Japan, South Korea and Taiwan, focused on Big D.

## Big R: It's all in the chemistry

Great ideas and innovative approaches can come from any direction, so we purposely operate our R&D model to ensure we collaborate with many partners to supplement and accelerate our learning and expertise. Of course, this includes working closely with our customers, but it also includes working closely with other companies in the materials and equipment sectors, and with world-leading institutes and universities. Historically, AZ has been very successful in licensing-in technologies and many of our most successful IC Niche product lines have their origins in this process. We continue to actively monitor and pursue these types of opportunities, both within our existing product lines and for technologies which would lead us into new fields.

AZ is also a member of several internationally renowned institutions which operate as industry consortia, solving technical issues common to a particular market segment. We are a member at *imec* in Belgium in both the IC patterning and advanced packaging programmes, where our on-site employees work with *imec* engineers and the staff of other member companies to develop materials which will be used for semiconductor production one or more generations in the future. We are also a member at SEMATECH, the US-based industry association, where work includes support for our EUV materials development.

Academia abounds with new ideas and AZ is tapping into this innovation wellspring by collaborating with universities and start-ups spun off from universities. Here we bring our product and market application knowledge to the table, while they bring their specialised research capabilities. For example, in 2012 we licensed new technology from and entered into a sponsored research programme with William Marsh Rice University in Texas for graphene nanoribbons – a novel form of carbon related to both graphene and carbon nanotubes that has interesting potential applications in a number of areas, including electronic and advanced optical devices. We view this kind of activity as a longer-term technology platform development rather than a short term programme leading to immediate revenue. Such collaborations are an important and proactive component of our R&D model.

Forward momentum continued

## A strong platform for growth

# Focused on collaborative R&D and new product development

### Case study: Optronics

#### Next-Generation Technology – Orthogonal

Organic electronics is a fast growing field with the potential to revolutionise consumer markets in lighting and displays. In the latter market, there is the promise of thin, lightweight and flexible displays based on plastic substrates where the electronic structures driving the display are made from organic semiconducting materials rather than silicon. One major issue in this field to date has been that the standard photoresist processes used for conventional glass substrates damage the organic semiconductors, requiring costly and cumbersome alternatives in their manufacture.

Orthogonal Inc. and AZ have been working together to develop a new material set which is compatible with organic semiconductor substrates, and can provide an enabling technology for the manufacture of personal devices which address the above consumer market needs. AZ has partnered with Orthogonal in order to bring this new material set to market, potentially allowing our customers to use existing industry-accepted manufacturing technologies. This approach makes adoption by the FPD manufacturers less risky than other approaches and can support faster adoption into commercial use. Our partnership with Orthogonal gives us an opportunity to extend our market leadership in patterning materials for the display area into organic and flexible electronics. Again, we consider this a long term technology development effort rather than a short term revenue generator.

| Orthogonal | AZ |
| --- | --- |
| • Proprietary photoresist package for organic electronics<br>• Access to intellectual property<br>• Early stage evaluations at key customers | • Relationships with key end-use customers<br>• Marketing and R&D support in Japan, South Korea and Taiwan<br>• Decades of photoresist development experience |

**Leveraging core competencies and open innovation**

**New product offering**

See Partnerships, our strength: pages 24 to 25

### Big D: Customer-focused solutions

Innovation and product development are central to the future of our business. The industries we serve are fast moving and our customers' processes are technically demanding. Although our products represent only a small fraction of the customers' overall production cost, often around 3%, they are vital to their manufacturing processes and overall success. Our customers therefore depend on us to develop new materials that enable them to run either new processes or existing ones at lower cost.

Many projects in the Big D category are extensions of our existing product lines. They may be adaptations to a customer's processes or re-formulations to meet their needs, or require new chemical approaches. What they all have in common is that we have to quickly turn around samples to enable frequent learning cycles, which is why we tend to locate Big D projects close to our customers. Working with and listening to our customers will result in better and quicker solutions than just working on our own. Finding out what they need to make them more efficient, cost effective and competitive – and then delivering the solutions when they need them – creates the critical match between developer and user.

### A balanced pipeline

AZ's innovations are intimately connected to our customers' product development roadmaps. To ensure we stay aligned with their evolving needs, we have regular face-to-face technical and business reviews and detailed discussions through which we share knowledge on the R&D challenges we jointly face. Through these, we find opportunities to develop differentiated and innovative products that help our customers succeed. We invest significantly in our R&D programmes – 7% of Group revenue in 2012, as well as significant capital – to improve the rate of innovation we offer. Increasing the speed of our product development efforts is critical to reaching a solution and bringing it to market more quickly.

The customer requirements which drive our R&D come from both short term and longer-term goals and targets. We can be working on product improvements which our customers will implement within a year while establishing new technical capabilities in fields that may not become commercial within the next five years. The shorter-term projects typically involve improving the performance of an existing product platform or adapting known technology to a customer's new manufacturing process to increase yield or reduce cost. For example, we are working with customers to apply our anti-collapse rinse materials to additional device layers for semiconductor products which will enter manufacturing this coming year.

Our customers' long term needs naturally tend to be less well-defined, so we focus on more general areas of materials and processing related to their intended market targets. Here, we usually work with customers on multiple technology paths so that when one of them clearly emerges as the path with the best fit, we can quickly move the technology into the development phase. For example, for sub-20 nanometre IC patterning, we are developing several different types of materials geared to EUV lithography, while also developing completely different approaches using materials such as DSA block copolymers.

### Patent Portfolio – granted and pending
by division (number)

| | |
|---|---|
| IC Materials | 1,828 |
| Optronics | 303 |
| Other | 108 |

### Patent Portfolio – granted and pending
by geography (number)

| | |
|---|---|
| Japan | 320 |
| USA | 265 |
| South Korea | 217 |
| Taiwan | 216 |
| China | 184 |
| Germany | 111 |
| France | 96 |
| ROW | 830 |

## Case study: IC Materials

### Solutions for the Next IC Nodes

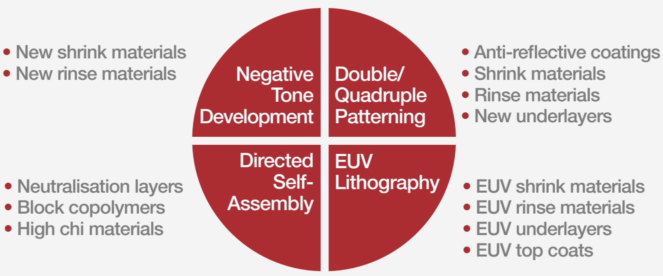
Our customers are focused on containing the rising cost of wafer processing for next node IC devices. We are stepping up to help them with products that can simplify processing and enhance yields and novel technologies that enable more advanced processing. Our development of these new materials is an example of our balanced pipeline approach.

The diagram below lists a number of lithographic technologies that are either already in use or on our customers' horizons. Some of these technologies are competing "either-or" approaches, while others can be complementary. Negative tone development and multiple patterning are already in use. Many, though not all, of AZ's development projects for these technologies are in the Big D category. Extreme ultra-violet ("EUV") lithography requires high investments and has been delayed by technical problems, but it promises to simplify patterning compared with today's complex solutions. Here, we are developing materials that can assist in the patterning of EUV photoresists and help overcome some of the current technical limitations of EUV exposure processes. Many projects in this area are intermediate between Big R and Big D.

Directed self-assembly ("DSA") is a very novel patterning approach where the self-organisation of a specialised coating creates the pattern's finest features. Lithography only serves to align these structures and guide them to the right location. This technology is clearly Big R – it promises to extend current lithographic techniques and tool sets for several future IC nodes, leading to a particularly cost-effective patterning solution. However, it is quite a departure from the way chips have conventionally been made.

It is not yet known when and how widely novel techniques such as EUV and DSA will replace the proven but costly multiple patterning practiced today – all of these technologies may even co-exist. However, we believe that AZ is well positioned with new product offerings to win in all of the scenarios.

**MORE MOORE**
**Customer Options for Continued Shrinking of Feature Sizes**




**AZ is well positioned to win in all scenarios**

> "Building an innovation pipeline, with the right balance between short, medium and long term projects, is critical to AZ's success. In doing so, we cannot rely solely on our in-house efforts. The partnership contribution from our customers and world-leading institutes and universities is crucial.

**Ralph Dammel**
Chief Technology Officer

### Process-focused control

AZ follows a disciplined marketing-driven R&D process, guided by an analysis of our R&D efforts. This is based on market size, market share potential, competitive lead, product life cycle and expected margin.

We guide our projects through a structured stage-gate development process, from the initial idea generation through to platform development, product formulation and testing, and then to qualification for manufacturing by our customers. At each stage, the project must meet a set of strict criteria before it passes to the next stage, since this often requires additional resources or capital investment. Each stage-gate review comprises a detailed assessment of the project's standing against its pre-agreed commercial and technical targets. The stages mirror our customers' decision points for evaluating new processes and products. By linking our project stage-gates to our customers' timings, we can better align our project management to our customers' critical milestones.

### Innovation is essential, R&D is the key

Delivering value to our customers flows directly from our continued innovation in chemistries and materials, and the processes to effectively make and utilise them. Our Big R, Big D model sets us apart, allowing us to differentiate what we offer to our customers as solutions to their problems, and to drive our growth. We strive to improve the number and quality of new ideas we generate and the speed with which we implement them across the R&D team and the entire AZ organisation. Our close customer alignment enables us to get these new ideas into their hands. If we do this quickly and meet their needs, we give our customers a competitive advantage. We call this a "Big Win".

Forward momentum continued
## A strong platform for growth

# People, our assets

AZ is a knowledge-based business driven largely by innovation, which puts people at the heart of our organisation. The quality of our people makes a real difference, as they give us a competitive advantage and hold the key to our success. They are innovative, ambitious and passionate about driving AZ forward and satisfying our customers every time.

# 1,092

The number of reasons to invest in AZ… our people

> I have only been on board a few months but I am already impressed by the passion and dedication of our people in supporting our customers' needs and solving their problems.

Daniel Wan
Group Human Resources Director

## Investing in people is core to our strategy

AZ employs a global and multicultural workforce of some 1,100 highly skilled men and women, many of whom are university and post-graduate qualified. We are a growing business and we strive to create a stimulating environment in which they can work and apply their skills. From the top down, we are focused on developing leadership and talent to secure strong succession and deliver our growth ambitions.

Through team work and continuous improvement, we encourage employees to work together to find new, more efficient ways of doing things. We continually engage and involve our people in our thoughts and plans to ensure they fully understand where the business is going and their vital role in getting us there.

## Attracting the best

AZ understands how important it is to attract the best people and our reputation for innovation gives us access to talent pools around the world. We aim to complement our existing workforce by recruiting the best people who fit our innovative culture. In 2012, we hired some 100 new employees to replace leavers, support our growth and supplement critical capabilities to implement our strategy. During the year, our recruitment focused on employing a high number of university graduates and post-graduates in R&D and production, with the aim of further strengthening our intellectual property base.

## Developing the best

We recognise the motivational and aspirational benefits of promoting from within, although this is not always possible. Our talent management and succession planning processes identify and develop individuals who show the potential to progress through the organisation with the right support and mentoring. We made a number of key senior management appointments in 2012, with the majority being internal appointees. This demonstrates our attention to developing our talent and succession pipeline.

The framework and process supporting our talent development will remain a critical focus area in 2013. We will also be looking to formalise our Group learning and development offerings and begin a number of programmes which will equip both individual contributors and leaders with the right skills and experience to progress their careers and drive AZ forward.

We encourage our employees to apply for international assignments as we seek to develop a diverse workforce in each country. Over time, this will create a talent pool capable of meeting the challenges that will arise from our expected growth.

## Retaining the best

Our employees' skills and knowledge have significant value in an increasingly global and competitive world. Retaining and building on these skills requires us to provide a stimulating work environment and to reward individuals appropriately for their contribution. Almost 40% of the Group's employees have service periods greater than 10 years.

In 2012, we put in place a process whereby the majority of employees set personal goals and objectives that are aligned to those of their business and functions. The process encourages employees to monitor their performance throughout the year and to amend their goals and objectives in line with those of the business and/or its support functions.

AZ's reward systems promote high performance that helps to attract and retain the best people. In particular, our remuneration policies and practices support a "Pay for Performance" approach. Achieving personal goals and objectives is a key measure in determining the performance-related element of an employee's pay and annual bonus. With a view to aligning their interests with those of shareholders, and providing our people with the opportunity to share in the success they help to create, the Company also operates a Long Term Incentive Plan and a recently introduced Employee ShareMatch Plan.

Forward momentum continued
**A strong platform for growth**

# Partnerships, our strength

Our partnerships with customers are vitally important to the long term success of AZ. These close relationships help us to create better solutions than just working on our own and can give us an all-important edge over our competitors. Ultimately, the focus of our customer relationships is to deliver products and services better, faster and more cost-effectively.

## 57%

The proportion of Group revenue generated from our Top 10 customers

"Opening our new TARC plant in Taiwan has demonstrated our trust and commitment to working with local customers. This has been well received and has certainly strengthened our partnership with them.

David Chen
General Manager, Hsinchu Operation (Taiwan)

### Investing in partnerships

A key aspect of AZ's partnering strategy is to "act locally" wherever possible, and we demonstrated this again in August 2012 with the completion of our plant expansion in Taiwan. This US$5m investment enables us to produce top anti-reflective coatings ("TARC") products, increasing our local manufacturing capacity in response to growing demand from our Taiwanese customers.

While we mainly based the expansion decision on the need to extend our local service offering, it was not a decision we could make on our own. It required buy-in from our Taiwanese customers as the change in manufacturing location and process would need to undergo extensive qualification by them. Our customers saw that the value of improved application, customer support and security of supply would more than offset their investment in the 6–12 month qualification period. They also saw the benefit of having quick and easy access to AZ's technical staff with whom they could partner in any future developments.

We are also localising production of several major products to South Korea. In 2012, we completed a US$20m investment to expand our Anseong facilities for dielectrics, part of our IC Niche product portfolio. Construction of the new production, administration and warehousing facilities is complete and customer qualification is expected to take place in the first half of 2013.

These investments in Taiwan and South Korea demonstrate our commitment to forging long term relationships and delivering a globally leveraged network to our customers' doorstep.

### Quality is everything

Quality is crucial to our customers as defective products can have a material impact on their productivity and ultimately their profitability. That is why they invest heavily in ensuring that they only partner with preferred suppliers like AZ, who deliver materials that consistently meet specification. Our customers therefore apply a rigorous quality assurance programme which dictates that our materials and production processes must first be qualified by them before they accept any of our materials. The close relationships we forge with our customers allow us to engage with them early in the development stage and find the quickest route to qualification and new material delivery, something which is clearly in both parties' best interests.

Following qualification, we aim to ensure all products that leave our plants either meet or exceed our customers' specification. We do this by applying strict controls and quality assurance checks throughout the production process, and we issue a certificate of specification compliance with all deliveries. Samples of each production batch are also retained in case further analysis is required.

Our quality record is reflected in a customer complaint rate of just 0.2% for each of the last four years. This is testament to the time and resource we invest in ensuring our customers receive quality products from us every time, on time. On the rare occasions when a customer does have an issue with our materials, we have a robust problem solving mechanism to resolve the issue quickly.

### Enhancing our reputation

By building strong partnerships with our customers, we enhance our reputation in the industry. Our customers are market leaders and so are we. In working closely with them, and understanding their environment, we aim to build on our market leadership positions.

# Outperformance of underlying markets in IC Niche

**12%**
Proportion of IC Niche revenue invested in R&D

## IC Materials

### Operational highlights

- Revenue down 1% to US$537.2m (flat at constant currencies[1])
- EBITDA margin[1] maintained at 40.2%
- Outperformance of underlying markets in IC Niche, driven by demand for yield enhancement and Klebosol® colloidal silica materials
- Investment during the year in new and enabling lithographic materials for use in leading-edge semiconductor fabrication
- US$21m invested in expanded facilities in South Korea and Taiwan for localised supply of IC Niche materials

### Financial highlights 2012

| | 2012 US$m | 2011 US$m | Increase/(Decrease) (as reported) | Increase/(Decrease) (at constant currencies) |
|---|---|---|---|---|
| IC Niche | **356.0** | 352.1 | 1% | 3% |
| IC Conventional | **181.2** | 193.0 | (6)% | (5)% |
| **IC Materials – Total Revenue** | **537.2** | 545.1 | (1)% | – |
| EBITDA[1] | **215.8** | 219.2 | (2)% | (1)% |
| EBITDA margin[1] | **40.2%** | 40.2% | – | (0.5)pts |

"We remain excited about the incremental opportunities created by further advances in semiconductor manufacturing and believe we are well positioned to support all possible outcomes.

Rico Wiedenbruch
Managing Director, IC Materials Division

## Operational performance

### IC Materials

The IC Materials Division produces and sells materials used in the manufacture of integrated circuits ("ICs"). The division comprises the IC Niche materials and IC Conventional materials businesses, where demand for these products is broadly correlated to the production and use of silicon wafer starts at our customers' fabrication facilities ("fabs").

IC Materials revenue decreased by 1% to US$537.2m (flat at constant currencies[1]), and represented 68% of the Group's total revenue in the year (2011: 69%). EBITDA[1] decreased by 2% to US$215.8m (down 1% at constant currencies[1]), in line with the slight reduction in revenue.

### IC Niche

Revenue increased by 1% to US$356.0m (up 3% at constant currencies), ahead of the 2% estimated reduction in the underlying market, as measured by year-on-year industry growth of memory wafer starts by DRAMeXchange, the independent market forecaster. This was primarily driven by strong demand for yield enhancement materials used in new technology nodes of our customers' products, particularly those in the IC foundry segment, as well as sales of AZ's Klebosol® colloidal silica materials which continued to progress well.

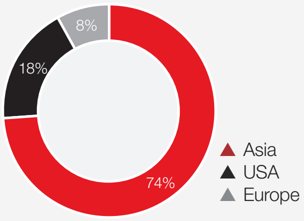
As expected, revenues from AZ's Spinfil® dielectric materials were impacted by dual-sourcing by certain customers, largely in relation to generic DRAM applications (used in, for example, desktop PCs). Much of the revenue loss in this area relates to intellectual property which is the subject of a lawsuit filed against a Korean competitor, where the Group alleges infringement of certain intellectual property rights relating to our dielectric technology. Aside from this, AZ is making good progress with new applications of its dielectric materials for leading-edge semiconductor manufacturing. In addition, and as we would expect, some of our customers using relatively large dispense-volumes of our dielectric materials have reduced the amount dispensed per wafer as they optimise production. Although this trend is a typical feature of our customers' manufacturing processes, the effect has been to offset some of the benefits seen from increased node and product penetration.

AZ's yield enhancement materials continue to drive sales of our lithographic IC products, with good progress made in our top anti-reflective coatings ("TARC") business, especially at certain foundry customers in South Korea and Taiwan. Our pattern enhancement products, particularly our RELACS® shrink material, also continued to perform well, with AZ benefiting from accelerated use of the material at a major memory chip customer.

We completed the expansion of our Taiwanese and Korean facilities during the year. The new Taiwanese facility has recently commenced production of TARC products. In South Korea, qualification processes are underway for AZ's Spinfil® dielectric materials, and we expect the facility to be fully operational in 2013. These new facilities further strengthen our collaborative activities with key customers in Taiwan and South Korea and provide them with a more localised,

Note:
1. See definitions in Financial Review on page 30

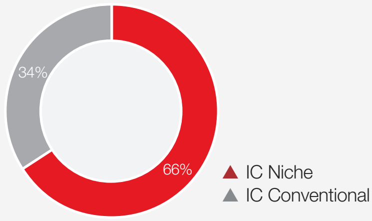
## IC Materials revenue by geography (%)




74%

The amount of IC Materials revenue which comes from Asia

## IC Materials revenue by sub-segment (%)




66%

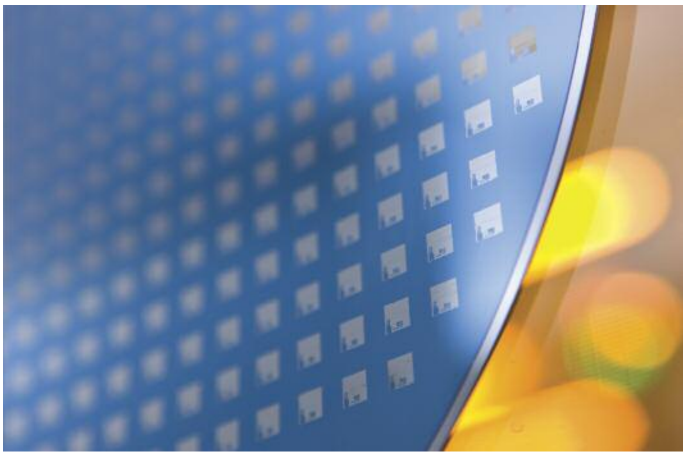
The amount of IC Materials revenue which comes from IC Niche

secure and cost-efficient supply chain. In November, we commenced work on the expansion of colloidal silica manufacturing capacity at our Lamotte facility in France, which will allow us to meet growing demand for non-electronic applications of AZ's Klebosol® product. The additional capacity is scheduled to become operational during the second half of 2013.

We remain excited about the incremental opportunities created by further advances in semiconductor manufacturing and believe we are well positioned to support all possible outcomes. Materials to support extreme ultra-violet ("EUV") lithography, as well as alternative enabling technologies for sub-20 nanometre semiconductor fabrication, are qualified and ready for use. Moreover, the Group continues to explore directed self-assembly ("DSA") as a cost-effective and viable patterning technique for sub-20 nanometre applications, as well as in advanced methods of contact hole rectification. DSA continues to attract significant interest and engagement from our major IC customers and our development work for both applications is progressing well.

### IC Conventional

IC Conventional revenues for the year were down 6% at US$181.2m (down 5% at constant currencies). The underlying decrease was in line with total industry wafer starts, which are estimated to have reduced by 3% over the same period (based on an estimate made by the independent market forecaster VLSI Research). The Group saw good volume growth from the semiconductor packaging sector, notably with our thick film resists ("TFR"), masked by the proactive ceding of around US$18m of certain edge bead remover ("EBR") business to local competitors due to uneconomic supply arrangements.



Business reviews
**Operating review** continued

# Strong growth in Optronics driven by customer wins

13%

The year-on-year increase in Optronics revenue in the second half of 2012

## Optronics

### Operational highlights

- Revenue up 6% to US$236.9m (up 6% at constant currencies[1])
- EBITDA margin[1] increased to 28.7%
- Strong second half performance in FPD Photoresist, driven by customer wins and improved trading in the global flat panel display industry
- Good progress in Light & Energy business, particularly in LEDs for display back-lighting
- R&D expenditure focused on new applications for our proprietary silicon chemistry

### Financial highlights 2012

| | **2012 US$m** | 2011 US$m | Increase/(Decrease) (as reported) | Increase/(Decrease) (at constant currencies) |
|---|---|---|---|---|
| FPD Photoresist | **188.0** | 177.2 | 6% | 7% |
| Optronics Other | **48.9** | 46.9 | 4% | 4% |
| **Optronics – Total Revenue** | **236.9** | 224.1 | 6% | 6% |
| EBITDA[1] | **67.9** | 62.8 | 8% | 9% |
| EBITDA margin[1] | **28.7%** | 28.0% | 0.7pts | 0.8pts |

"In Optronics, AZ will benefit from new and innovative display technologies where we believe our new enabling Si-Tech materials can add significant value to our customers' processes.

Anand Nambiar
Managing Director, Optronics Division

## Operational performance

### Optronics

The Optronics Division produces and sells materials that are critical to the manufacture of flat panel displays ("FPDs"). There are two product categories within the division: FPD Photoresist, which supplies light-sensitive processing materials for FPDs; and Optronics Other, which includes EBRs, other ancillaries and silicon chemistry-based products for AZ's Light & Energy business (serving displays, lighting and other non-electronic markets). Demand for FPD Photoresist products is broadly correlated to the area of FPD glass substrate utilised at our customers' manufacturing lines.

Revenue for this division increased to US$236.9m (up 6% at both actual and constant currencies[1]) and represented 30% of the Group's total revenue in 2012 (2011: 28%). Demand from touch panel customers remained strong and the primary driver of the FPD industry's recent strength, due to the continued demand for and proliferation of mobile devices such as smartphones, tablet computers and e-readers. EBITDA[1] increased by 8% to US$67.9m (up 9% at constant currencies[1]).

### FPD Photoresist

Revenue in this product line increased by 6% to US$188.0m (up 7% at constant currencies), seven percentage points behind the growth of glass area over the same period (based on a growth estimate of 14% made by the independent market forecaster, DisplaySearch). While the revenue performance is in line with our expectations for the year, the relative underperformance versus glass growth was largely attributable to planned price reductions, adverse customer mix and lower utilisation of our materials at certain customer fabs that completed refurbishment programmes during the year in order to accommodate advanced LCD applications.

Good progress was made in the second half of 2012, with AZ benefiting from new business wins in Taiwan and Japan. Local supply disruptions led to certain customers switching lines to AZ, recognising our ability to support their supply requirements and the launch of new LCD technologies.

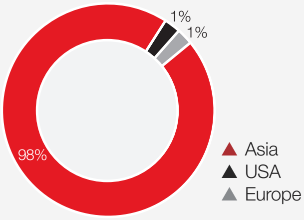
AZ also benefited from generally increased utilisation rates at our FPD customers as the year progressed. Consumer appetite for displays with higher resolution, brightness and frame-refresh rates is leading to increased industry investment in new and innovative platforms such as Organic LED ("OLED"), and transitions within the LCD space to advanced technologies such as low temperature poly-silicon ("LTPS") and indium gallium zinc oxide ("IGZO"). Such platforms require advanced chemical materials, including increased photoresist consumption. Several of our customers are developing new fabrication facilities in China, or re-equipping existing LCD plants elsewhere in Asia to support these new technologies. In addition, photoresist utilisation ramped up during the year at two recently-completed customer fabs for FPDs in China.

### Optronics Other

Optronics Other revenue increased to US$48.9m (up 4% at both actual and constant currencies). Our performance in this area was driven by good progress in our Light & Energy business, particularly in LEDs for display back-lighting, offset only by reduced year-on-year sales of low value-added EBR and ancillary business.

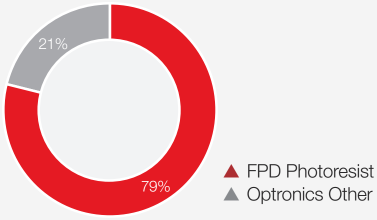
Note:
1. See definitions in Financial Review on page 30

### Optronics revenue by geography (%)




98%
The amount of Optronics revenue which comes from Asia

### Optronics revenue by sub-segment (%)




79%
The amount of Optronics revenue which comes from FPD Photoresist

We continue to leverage our world class silicon chemistry capabilities in IC Materials to develop new materials (siloxanes and silazanes) for our leading Optronics customers. These silicon technology materials, currently undergoing extensive qualification processes at our customers, are incremental to the use of photoresist and used principally for planarisation and dielectric insulation processes. They have a diverse range of applications, including OLED displays, flexible displays, advanced LCD displays (such as ultra-high definition televisions) and also in general lighting (in particular, high brightness LED lighting), which is expected to overtake the display back-lighting market as the largest user of LEDs within a few years. The small acquisition we made in India in October 2011 is now fully integrated and supporting this development.

During the year, AZ entered into licensing and sponsored research agreements with William Marsh Rice University in the field of graphene nanoribbons, for application to electronic and advanced optical devices. This augments our platform for long term growth and adds further weight to our belief that new and advanced display technologies and LED lighting are significant and exciting long term market drivers where AZ is well positioned.

### Printing and Other

Products in the Printing and Other Division are used to make printing plates for the production of printed materials including newspapers, magazines and books.

Revenues in the year were in line with our expectations, decreasing by 12% to US$19.8m (down 5% at constant currencies[1]). EBITDA[1] for the year was US$2.0m (2011: loss of US$0.8m), benefiting from measures taken in 2011 to reduce the cost base.

From 1 January 2013, Printing has been included within our IC Materials Division (under IC Conventional), so that it is aligned to and reflects our new management structure.

Business reviews
**Financial review**

# A solid financial platform for future growth

## Highlights

### Summary financial highlights 2012

- Group revenue US$793.9m, flat versus 2011 (at constant currencies[5], up 2%)
- EBITDA US$262.4m, up 1% (at constant currencies[5], up 1%)
- EBITDA margin maintained at approximately 33%
- Adjusted Earnings per Share up 1% to 35.4 cents per share
- Strong cash flow reduced net debt to US$289.4m; net debt to EBITDA multiple improved to 1.1 times
- Group debt refinance of approximately US$500m completed

| | 2012 US$m | 2011 US$m | Change |
|---|---|---|---|
| Revenue | **793.9** | 791.8 | **–** |
| EBITDA[1] | **262.4** | 261.0 | **+1%** |
| EBITDA margin[1] | **33.1%** | 33.0% | **+0.1pts** |
| Operating Profit | **150.7** | 150.7 | **–** |
| Profit before Tax | **129.1** | 125.6 | **+3%** |
| Profit after Tax | **82.9** | 96.5 | **-14%** |
| Basic Earnings per Share (cents) | **21.8** | 25.3 | **-14%** |
| **Adjusted (underlying):** | | | |
| Profit after Tax[2] | **134.7** | 134.1 | **–** |
| Earnings per Share[3] (cents) | **35.4** | 35.2 | **+1%** |
| Operating Cash Flow[4] | **204.4** | 206.3 | **-1%** |
| Net Debt | **289.4** | 343.4 | **-16%** |
| Leverage (x EBITDA) | **1.1** | 1.3 | **(0.2)** |
| Dividend per Share (cents) | **13.1** | 12.3 | **+7%** |

33.1%
EBITDA margin

78%
Conversion of EBITDA into Operating Cash Flow

US$289m
Net Debt at the year end, representing 1.1 times EBITDA

Notes:
1. **EBITDA** is defined as operating profit before depreciation and amortisation of intangible assets. For the years 2008 to 2010 EBITDA was further adjusted for exceptional items, and monitoring fees. There were no exceptional items or monitoring fees impacting EBITDA during the 2011 and 2012 financial years. The requirement to pay monitoring fees to AZ's previous shareholders ceased on 3 November 2010. **EBITDA margin** is calculated by dividing EBITDA by revenue.
2. **Adjusted Profit after Tax** is Profit after Tax adding back amortisation of intangible assets, net of tax.
3. **Adjusted Earnings per Share** is Adjusted Profit after Tax divided by the weighted average number of shares in issue during the year.
4. **Operating Cash Flow** is defined as EBITDA with charges in relation to share-based payments added back, less any changes in working capital (excluding those relating to transaction costs), less net cash payments in relation to capital expenditure and, in respect of 2012, after adding back charges relating to share-based payments.
5. **Constant currency** movements calculated by comparing 2012 results with 2011, retranslated at weighted average 2012 exchange rates.

"2012 was a challenging year due to the uncertain macro environment, but we delivered a solid performance nonetheless and the results were in line with our expectations.

Mike Powell
Chief Financial Officer

AZ delivered a solid revenue performance in 2012, in line with our expectations, together with sustained profitability and strong underlying cash flow generation. The Group's balance sheet continued to strengthen and AZ refinanced its debt facilities.

The Group's revenue for the year was US$793.9m (2011: US$791.8m), while Group EBITDA was also at a similar level to the previous year, at US$262.4m (2011: US$261.0m). The Group EBITDA margin was therefore broadly unchanged at 33.1% (2011: 33.0%).

Currency translation reduced revenue by US$9.7m and EBITDA by US$0.1m. At constant currencies, revenue was up by 2% and EBITDA increased by 1%.

The Group maintained its strategic focus on market-leading and innovative niche products, such as those within IC Niche and FPD Photoresist, which together represent 69% of the Group's revenue (2011: 67%). The focus towards such high value-added and critical materials, together with robust sales volumes and solid material cost controls, helped to mitigate the impact of normal selling price reductions resulting in a stable Group gross margin for the year of 47.1% (2011: 46.8%).

Operating profit of US$150.7m was flat versus the previous year (2011: US$150.7m), with the Group's higher gross profit in 2012 being offset by approximately US$3m of additional R&D investment and depreciation. Profit before tax increased to US$129.1m (2011: US$125.6m). On a like-for-like basis, after adjusting for a one-off deferred tax credit of US$15.0m that was included in the previous year's earnings, the Group's profit after tax in 2012 of US$82.9m was 2% higher than the previous year (2011: US$81.5m) and basic earnings per share were 21.8 cents (2011: 21.4 cents). Reported profit after tax in 2011 was US$96.5m and reported basic earnings per share in 2011 were 25.3 cents. Adjusted Profit after Tax, which adds back amortisation net of related tax, was US$134.7m (2011: US$134.1m) and Adjusted Earnings per Share were 35.4 cents (2011: 35.2 cents).

## A solid performance in IC Materials and Optronics

The first half of the year was characterised by challenging trading conditions, with revenues across both core businesses improving in the second half.

### Revenue

| | H1 2012 US$m | H2 2012 US$m | 2012 US$m | 2011 US$m | Increase/(Decrease) (as reported) | Increase/(Decrease) (at constant currencies) |
|---|---|---|---|---|---|---|
| IC Materials | | | | | | |
| – IC Niche | 175.9 | 180.1 | 356.0 | 352.1 | 1% | 3% |
| – IC Conventional | 89.9 | 91.3 | 181.2 | 193.0 | (6)% | (5)% |
| **Total IC Materials** | **265.8** | **271.4** | **537.2** | **545.1** | **(1)%** | **–** |
| Optronics | | | | | | |
| – FPD Photoresist | 85.9 | 102.1 | 188.0 | 177.2 | 6% | 7% |
| – Optronics Other | 22.2 | 26.7 | 48.9 | 46.9 | 4% | 4% |
| **Total Optronics** | **108.1** | **128.8** | **236.9** | **224.1** | **6%** | **6%** |
| **Printing and Other** | **9.7** | **10.1** | **19.8** | **22.6** | **(12)%** | **(5)%** |
| **Group** | **383.6** | **410.3** | **793.9** | **791.8** | **–** | **2%** |

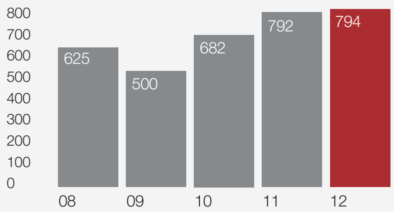
While IC Materials saw some demand variations from quarter to quarter, its market was generally subdued due to ongoing macroeconomic uncertainty and some supply imbalances at our customers. As a result, growth in wafer starts – a fundamental demand driver for the IC Materials business – was muted in 2012. IC Materials revenue, at US$537.2m, was 1% lower than last year. Revenue in the second half of the year increased by 2% over the first half, but was down 2% compared to the same period last year (H2 2011: US$275.9m).

The EBITDA margin for the IC Materials Division was maintained at 40.2% (2011: 40.2%), despite the 1% overall year-on-year decline in IC Materials revenue, reflecting the proactive ceding of low value-added EBR business within IC Conventional, together with solid cost controls over materials and overheads.

The Optronics business grew more strongly as the year unfolded, driven by consumers' appetite for mobile display technologies. In FPD Photoresist, the Group extended its market position in Taiwan and Japan through significant customer wins as we once again leveraged our technology advantages, supply chain security, product quality and reliable order execution. Optronics revenue, at US$236.9m, was 6% higher than last year and EBITDA was 8% higher at US$67.9m, resulting in an increase in EBITDA margin to 28.7% (2011: 28.0%). Revenue in the second half of the year was up 13% on the same period last year (H2 2011: US$114.3m) and up 19% on the first half of 2012.

# Business reviews
## Financial review continued

### Group revenue (US$m)




US$793.9m

### Revenue by geography (US$m and %)

▲ Asia US$632.6m
▲ USA US$97.5m
▲ Europe US$63.8m

Asia 80%
USA 12%
Europe 8%

Revenues in the Printing and Other Division were down by 12% in 2012, from US$22.6m to US$19.8m, although revenues in the second half of 2012 were in line with both the first half of the year and the second half of 2011 (H2 2011: US$9.8m). Changes made to the Printing cost base in 2011 returned the business to profitability in 2012, reporting EBITDA of US$2.0m for the year (2011: loss of US$0.8m) with an associated EBITDA margin of 10.1% (2011: minus 3.5%). From 1 January 2013, Printing has been included within our IC Materials Division (under IC Conventional), so that it is aligned to and reflects our new management structure.

Corporate costs increased by US$3.1m (15%) over the previous year, due in the main to increased share option costs, salary inflation and the legal costs of a patent infringement action which ran throughout the year.

### EBITDA[1]

| | H1 2012 US$m | H2 2012 US$m | 2012 US$m | 2011 US$m | Increase/(Decrease) (as reported) | (at constant currencies) |
|---|---|---|---|---|---|---|
| IC Materials | 104.0 | 111.8 | 215.8 | 219.2 | (2)% | (1)% |
| *Margin %* | 39.1% | 41.2% | 40.2% | 40.2% | – | (0.5)pts |
| Optronics | 30.5 | 37.4 | 67.9 | 62.8 | 8% | 9% |
| *Margin %* | 28.2% | 29.0% | 28.7% | 28.0% | 0.7pts | 0.8pts |
| Printing and Other | 1.1 | 0.9 | 2.0 | (0.8) | 350% | 334% |
| *Margin %* | 11.3% | 8.9% | 10.1% | (3.5)% | 13.6pts | 14.2pts |
| Corporate costs | (10.5) | (12.8) | (23.3) | (20.2) | 15% | 20% |
| **Group** | **125.1** | **137.3** | **262.4** | **261.0** | **1%** | **1%** |
| *Margin %* | 32.6% | 33.5% | 33.1% | 33.0% | 0.1pts | (0.3)pts |

### Customer-focused investment

During the year, AZ invested US$55.8m into R&D (2011: US$54.0m), representing 7.0% of Group revenue (2011: 6.8%). Of this expenditure, US$43.4m was in the IC Materials Division – primarily in IC Niche products – which represented 8.1% of IC Materials revenue (2011: US$41.0m, 7.5%). R&D expenditure in the Optronics Division was US$11.6m, being 4.9% of Optronics revenue (2011: US$10.6m, 4.7%), reflecting the continued focus on new applications of AZ's proprietary silicon chemistry. R&D costs have been fully expensed in the Group's income statement as the costs do not meet the strict capitalisation criteria under IAS 38 "Intangible Assets" at the time such costs are incurred.

Capital expenditure in the period was US$50.7m (2011: US$50.5m), of which US$14.2m (2011: US$20.9m) was invested in advanced equipment used in R&D to develop new products. Capital investment to expand production capacity was US$27.2m (2011: US$19.7m) and a further US$9.3m (2011: US$9.9m) was invested to support AZ's asset base.

Major capital expenditure projects during the year included the completion of a plant expansion in Taiwan (c. US$3m) and South Korea (c. US$18m), and also the commencement of a project in France to expand its colloidal silica capacity (c. US$1m, with approximately US$6m to follow in 2013).

### Continued strong cash generation

In 2012, the conversion of EBITDA into Operating Cash Flow was 78% (2011: 79%). Strong cash generation continues to be a key focus for the Group.

### Operating Cash Flow[4]

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **EBITDA** | **262.4** | 261.0 |
| Share-based payments charge | 1.9 | – |
| Changes in net working capital | (8.8) | (5.2) |
| Cash capital expenditure (net) | (51.1) | (49.5) |
| **Operating Cash Flow** | **204.4** | 206.3 |
| **Cash flow conversion** | **78%** | 79% |

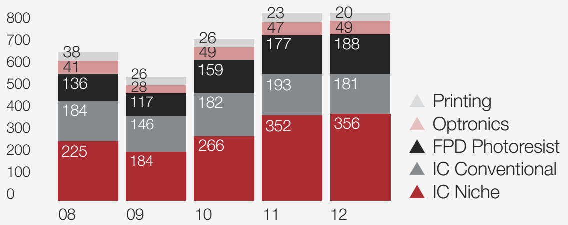
Cash generated from operations during the year was used to pay interest of US$19.4m, tax of US$84.9m, a final dividend of US$32.4m (in respect of the 2011 financial year), an interim dividend of US$15.2m (in respect of the 2012 financial year) and net capital investments totalling US$51.1m. Capital expenditure for this purpose is different to the additions to tangible and intangible fixed assets from the Group's balance sheet because of the timing of payments. A total of US$492.7m of debt was repaid during the year, mainly in December as AZ refinanced its debt facilities. New bank loans of US$398.0m (net) were drawn.

### A strong balance sheet

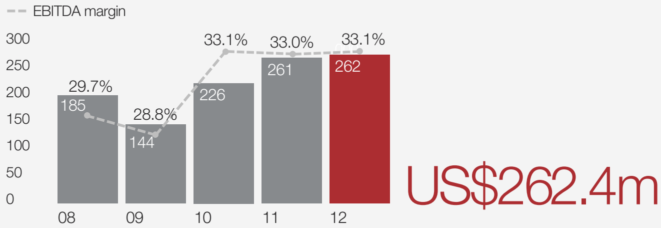
At 31 December 2012, outstanding borrowings were US$399.0m (31 December 2011: US$491.4m) and cash balances amounted to US$109.6m (31 December 2011: US$148.0m). Net debt was therefore US$289.4m (31 December 2011: US$343.4m), giving a ratio of net debt to EBITDA of 1.1 times at the end of the year (31 December 2011: 1.3 times).

In December, we completed the refinancing of our Group debt facilities with the establishment of new 4.5-year facilities totalling approximately US$500m, comprising US$125m and €45m of amortising term debt and a US$315m revolving credit facility with a final maturity of April 2017. The new facilities have been syndicated to a group of UK and international banks, and reflect the transition from a leveraged pre-IPO facility to a corporate debt facility.

## Revenue by product group (US$m)




## EBITDA and EBITDA margin[1] (US$m and %)




Covenants attached to our new debt facilities compare EBITDA to net debt (maximum of 2.75 times), and to interest costs (minimum 4 times). At 31 December 2012, AZ's performance was well within the covenant criteria.

The maturity profile of the Group's borrowings as at 31 December 2012 was as follows:

### Debt Maturity Profile

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Within one year | 6.2 | 18.2 |
| In the second year | 20.9 | 22.5 |
| In the third to fifth years inclusive | 371.9 | 450.7 |
| **Total** | **399.0** | 491.4 |

At 31 December 2012, 85% of the Group's borrowings were denominated in US Dollars (2011: 86%) and the remaining 15% was denominated in Euros (2011: 14%).

AZ intends to maintain a strong balance sheet going forward and we continuously seek to optimise our allocation of capital in order to meet the strategic needs of the business, namely: investment in the organic growth of the business, further reducing net debt and supporting our progressive dividend policy whilst maintaining sufficient flexibility to be able to pursue acquisitions if appropriate. We are clear that any transaction must be capable of delivering sustainable long term value for shareholders in line with our strategic objectives. We will continue to evaluate options with regards to applying surplus funds in order to deliver attractive long term returns to shareholders whilst ensuring that we have sufficient balance sheet flexibility to pursue our core strategic needs as outlined above.

### Finance costs and Tax

Finance costs in the year were US$23.3m, a reduction of US$3.4m compared to the previous year (2011: US$26.7m). This included interest costs on bank overdrafts and loans of US$13.6m (2011: US$15.5m) and interest rate swap costs of US$6.4m (2011: US$10.8m). Details on how the Group manages the interest rate risk that is associated with its borrowings can be found in Note 26 to the consolidated financial statements.

The tax charge for the year was US$46.2m (2011: US$44.1m), representing an effective tax rate of 35.8% (2011: 35.1%). The comparative year tax charge and effective tax rate are stated after adjusting for a non-recurring credit of US$15.0m that arose in the previous year following a change in the Japanese corporate tax rate in December 2011. The reported tax charge and effective tax rate in the 2011 financial year were US$29.1m and 23.2% respectively.

The reported tax charge for the year comprises a current tax charge of US$82.9m (2011: US$71.3m) offset by a net deferred tax credit of US$36.7m (2011: US$42.2m) relating to withholding taxes and the amortisation of intangible assets. The current tax charge reflects our best estimate of the tax payable in each of the jurisdictions in which we operate.

### Earnings per share

On a statutory basis, basic earnings per share in 2012 were 21.8 cents (2011: 25.3 cents) and diluted earnings per share were 21.7 cents (2011: 25.3 cents), as detailed in Note 13 to the consolidated financial statements. The comparative year figures reflect the impact of a one-off deferred tax credit of US$15.0m. Excluding this, basic and diluted earnings per share in 2011 were 21.4 cents.

Whilst the basic and diluted earnings per share are disclosed in accordance with statutory requirements, the Directors believe that Adjusted Earnings per Share ("EPS"), with amortisation of intangible assets (net of related tax) added back, provides a better basis for comparison with other companies than statutory earnings per share. Adjusted EPS, calculated as Adjusted Profit after Tax divided by the weighted average number of shares in issue during the year, were 35.4 cents (2011: 35.2 cents). In arriving at Adjusted Profit after Tax for the year of US$134.7m, amortisation of intangible assets of US$51.8m (stated net of corresponding current and deferred tax credits of US$30.8m) has been added back to profit after tax.

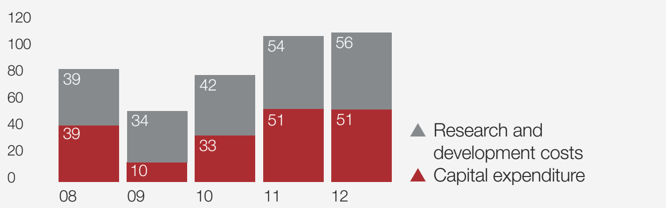
### Dividend

The Board is recommending a final dividend of 9.1 cents per Ordinary share for 2012 which, when added to the interim dividend paid of 4.0 cents per Ordinary share, brings the total dividend per Ordinary share for the full year to 13.1 cents, up 7% from the previous year (2011: 12.3 cents). Subject to shareholders' approval, the final dividend will be paid on 3 May 2013 to shareholders on the register at the close of business on 15 March 2013. The ex-dividend date is 13 March 2013.

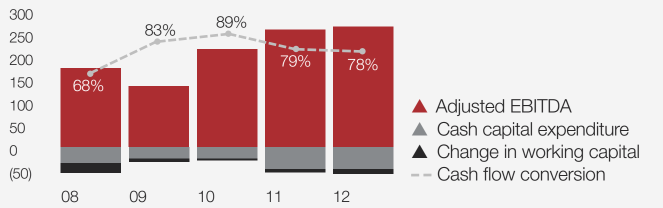
Dividends are declared in US Dollars and, unless a shareholder elects to receive dividends in US Dollars prior to 8 April 2013, will be paid in GB Pounds Sterling. This will be at the exchange rate prevailing on or about 15 April 2013 and confirmed by means of an RNS announcement to the London Stock Exchange on or about 16 April 2013.

# Business reviews
## Financial review continued

**Investment in R&D and capex** (US$m)




**Cash flow conversion** (US$m and %)




### Currency impact on trading
AZ reports its results in US Dollars and conducts its business in many foreign currencies. With 42% of AZ revenues being generated in US Dollars during the year (2011: 40%), the other important trading currencies are:

- Japanese Yen: 30% of 2012 Group revenue (2011: 31%)
- Taiwanese Dollar: 16% of 2012 Group revenue (2011: 17%)
- Euro: 6% of 2012 Group revenue (2011: 7%)
- Korean Won: 2% of 2012 Group revenue (2011: 2%)

The Group's results are also exposed to the transactional foreign exchange risk that arises when subsidiaries enter sales and/or purchase contracts in currencies other than their local currency. The most significant impacts arise as our Korean and Taiwanese subsidiaries conduct a portion of their trading in US Dollars and Japanese Yen. Group Treasury seeks to manage its transactional foreign exchange risks by managing the net portion in each foreign currency using external forward currency contracts. Further details about management of foreign exchange risk can be found in Note 26 to the consolidated financial statements.

Based on the current mix of non-US Dollar denominated revenue and profit, a movement of 1% in the Group's non-US Dollar trading currencies (relative to the US Dollar) changes revenue by approximately US$5m and EBITDA by approximately US$1m.

### Retirement benefit obligations
The Group operates various defined benefit and defined contribution pension arrangements, as well as other post-employment benefit schemes. At 31 December 2012, the accumulated benefit obligation recognised in the balance sheet in relation to these arrangements and schemes was US$15.8m (2011: US$14.4m).

With effect from 1 January 2013, and in accordance with IAS 19 (revised) "Employee Benefits", AZ has increased its pension liability on the Group's balance sheet by US$7.1m (charged directly to equity) in respect of that part of the liability which until that date had been deferred in accordance with the "corridor" approach, as allowed under the provisions of the original IAS 19.

Further details are set out in Note 28 to the consolidated financial statements.

### Risk management and internal controls
The main risks facing the Group and how we mitigate them are reviewed on pages 35 to 37.

Robust management information systems and business planning processes have been central to the development of the Group thus far. To ensure the continued resilience of our systems, a Group-wide programme of internal control and risk management is in place, which includes targeted reviews of systems and processes as part of a coordinated internal audit programme.

Further information on internal controls is included in the Corporate Governance Report on pages 53 to 59 and Principal Risks and Uncertainties are detailed on pages 35 and 37.

Business reviews
## Principal risks and uncertainties

# We are committed to effective risk management and internal controls which support the achievement of our strategy and business objectives

AZ operates a risk management framework that enables our risks to be identified, analysed, evaluated, controlled, monitored and reported though a structured and consistent process. The Board is ultimately responsible for maintaining effective risk management, which includes our risk governance structure, our system of internal control and our internal audit approach. Management's responsibility is to manage risk across the Group on behalf of the Board. The Corporate Governance Report on pages 53 to 59 provides further details of this established process which was operated throughout 2012.

During 2012, we completed a Group-wide risk review programme involving AZ's senior management team, and will extend this to local operating level risk reviews in 2013. The Chief Executive leads this programme, supported by the Head of Risk and Strategic Projects.

Risks are identified through workshop based processes and analysed into eight core risk categories:

| Category | Description |
|---|---|
| Strategic | • The risks of not delivering our business objectives, as a result of changes in the competitive, economic and technological environments |
| People | • The risks of not recruiting and retaining the best staff, or having an appropriately skilled and motivated staff pool in order to deliver our business objectives |
| Financial | • The risks of not maintaining a controlled financial infrastructure |
| Operations | • The risks of not sustaining a resilient and responsible supply chain, or protecting the business, our partners, our assets and AZ's reputation |
| Hazards | • The risks associated with large scale natural disasters |
| Governance | • The risks of not supporting key stakeholders in governing the business, through the timely and accurate delivering of management information |
| Compliance | • The risks of not complying with legislation and regulations and internal Group policies in each territory in which we operate |
| 'Left Field' | • Any other risks |

The principal risks and uncertainties that we have identified through this process are set out on pages 36 and 37.

### Risk mitigation
We assess major risks to determine whether we can mitigate them to an acceptable level and reduce the net risk exposure to the business. We manage mitigation activities through risk projects, each of which is sponsored by a member of the Global Management Team ("GMT").

Projects that we initiated in 2012 to address major risks included:

- Mitigating the risk of failure in the product development process, by analysing our recent product development successes and failures to identify critical factors, and to identify areas across the product development process that require improvement;
- Mitigating the risk of failing to recruit the best talent, by developing a strategic human resources plan which is aligned with AZ's strategic objectives. This is being driven by the Group Human Resources Director and will identify the right mix of skills to meet AZ's future business requirements and drive our recruitment strategy; and
- Managing a major supply chain failure at one of AZ's key resin suppliers, through our dual sourcing risk mitigation strategy for key raw materials. This also lead to further risk mitigation activity to assess upstream dual sourcing risk for AZ's key raw materials suppliers, and hence further ensure the security of our critical supply chains.

Risk mitigation project managers report progress monthly to the Head of Risk and Strategic Projects, who in turn updates the GMT and the Board. The fourth quarter of 2012 saw the GMT undertake a full review of all major risk projects and this will continue as required to ensure that we deliver our risk mitigation activities.

### Risk review cycle
Our risk review cycle is shown in the diagram below. In 2012, we completed year two of the cycle (which commenced post IPO) with the objective of initiating key projects to mitigate major risks. The implementation plan to achieve year three of the cycle in 2013 is already under way.

2013 will see us extend our risk review programme to local operating level, to ensure that risk management becomes an integrated part of our daily agenda throughout the organisation.

Business reviews

## Principal risks and uncertainties continued

# Managing risk responsibly

| Risks | Risks description and impact | Approach to risk mitigation and management |
|---|---|---|
| **Dependence on the macroeconomic cycle** | AZ's business performance depends on demand for business and consumer electronic products and will fluctuate with the economic cycle.<br><br>A slowdown in general economic conditions, either globally or by territory, could affect demand for electronic products and thereby reduce our revenue and earnings. | • Close monitoring of customer demand forecasts, industry data and competitor activity.<br>• Tight control of production and overhead costs and inventory levels.<br>• Identification of new opportunities to use existing technologies outside the consumer electronics industry. |
| **Supply chain failure** | Supply chain failure or interruption could arise from:<br>• Disruption to raw materials supply;<br>• Loss of qualifying manufacturing status at an AZ or supplier site;<br>• Failure to manufacture to agreed quality standards;<br>• Poor supply chain management; or<br>• A natural disaster affecting the operation of an AZ or supplier site.<br>AZ supplies many of the leading players in the IC and FPD manufacturing industries, based on long-standing business relationships. Failure to supply a major customer could jeopardise future as well as current contracts leading to revenue loss and operating inefficiencies. Products that fail to meet required quality standards could result in product liability exposure. | • Business continuity plans are in place and regularly tested at each of our manufacturing operations.<br>• Quality control processes in all our production plants are certified to ISO 9001 standard.<br>• Qualification and certification of both current and alternative raw material suppliers are actively monitored.<br>• A supply chain management function proactively deals with supply issues and ensures that such issues are managed in a coordinated way between AZ and supplier sites. |
| **Failure to develop commercially successful new products** | AZ must develop and introduce new revenue generating products to replace older products which may either become obsolete or be replaced by new technologies and processes. The investment choices that AZ makes results from the knowledge and understanding of customer requirements in the markets in which it operates.<br><br>Failure to develop and produce products within customers' design schedules and timeframes could severely impact revenue and earnings. This could result in a loss of market share, weaken existing customer relationships and damage AZ's reputation as an industry leader.<br><br>As demand for new products increases, customers may also optimise their production processes, which may result in significant reduction in the volume of materials consumed. | • Maintenance of a world class integrated research and development platform.<br>• Proactive maintenance of close customer relationships in line with our "Partners in Innovation" philosophy. This enables AZ to proactively seek new product development and innovation opportunities with its existing customer base. |
| **Increased competitor activity** | Significant elements of our future growth plan are expected to come from current and future product opportunities with existing customers, leveraging the Group's position as the incumbent supplier, sometimes as a sole source of supply.<br><br>Customers could choose to diversify their supply base or source alternative products from the Group's competitors, leading to an erosion in AZ's market position and reducing both price and volume. In the worst case scenario, this could ultimately lead to the loss of a major customer. | • Proactive maintenance of close customer relationships in line with our "Partners in Innovation" philosophy.<br>• Location of AZ's manufacturing, operations, sales and customer service teams, in close proximity to our customers' manufacturing facilities.<br>• Effective management of the supply chain, ensuring ontime delivery of products to agreed specification and quality standards. |

The following information sets out the principal risks and uncertainties which we believe could cause future results to differ materially from our expectations. However, other factors could also affect our results and so the risks below should not be considered as a complete set of potential risks and uncertainties.

| Risks | Risks description and impact | Approach to risk mitigation and management |
| --- | --- | --- |
| **Failure to protect proprietary technologies** | A large proportion of AZ's revenue is attributable to patented products. Additionally, the Group's competitive position is strengthened by its unpatented technology and know-how.<br><br>Failure to protect proprietary information, technologies and know-how could lead to increased competition for existing and future products, resulting in reduced revenue and earnings growth. | • AZ actively manages its patent portfolio on a global basis and takes legal action as required in order to protect its intellectual property.<br>• Protection of unregistered intellectual property is managed through the inclusion of proprietary statements and clauses in documents and contracts with customers, suppliers and partners.<br>• AZ employees are subject to confidentiality obligations and are contractually obliged to acknowledge that all products, trade secrets, intellectual property and other processes developed in the course of their work are owned by AZ. |
| **Failure to recruit and retain the best talent** | The growth of AZ's business will be based on strong client relationships, established over a long period of time, and success in the development of new products. This will ultimately depend on AZ's ability to recruit and retain key employees with significant technical knowledge, market expertise and customer account management skills who can deliver against this need.<br><br>Failure to recruit and retain the best staff with specific technical and leadership skills, or ensure effective succession planning for key positions, could impact on AZ's ability to achieve its business objectives. | • AZ operates talent management, succession planning and training and development programmes.<br>• Competitive bonus and share-based incentives are in place, designed to attract and retain key employees for the longer-term. |
| **Increases in raw material prices** | Raw materials constitute a large proportion of AZ's manufacturing cost base.<br><br>Increases in raw material prices could increase AZ's manufacturing costs and reduce earnings. | • A Group procurement team purchases key raw materials on a global basis, thus maximising usage of price and volume models to influence and control costs.<br>• Pricing agreements with customers help reduce the impact and timing of price fluctuations. |
| **Fluctuations in foreign exchange rates** | The significant international spread of the Group's operations, covering Asia, Europe and the USA, exposes AZ to exchange rate fluctuations in these territories.<br><br>This arises as a result of potential mismatches between currencies in which revenues and expenses are denominated, when subsidiaries enter into transactions in a currency other than their local currency.<br><br>Fluctuations in exchange rates between the US Dollar, the Japanese Yen, Taiwanese Dollar, the Euro and Korean Won, could materially and adversely affect AZ's reported results.<br><br>The global nature of AZ's business exposes it to translation rate risk when consolidating numbers into US Dollars for financial reporting purposes. | • Transaction rate risk is managed centrally by a Group Treasury function which operates within a Group Treasury Policy. |
| **Risks associated with operating in different countries** | The Group's strategy is to serve its customers locally and establish its facilities close to where our key customers are located.<br><br>As a consequence, the Group is subject to various laws, rules and regulations in the different countries in which it operates, and is exposed to the financial, economic, political, business and tax risks associated with such countries. | • The Group has an established international reporting structure, where divisional and local country managers work with their colleagues who have specialist responsibilities for certain Group functions such as Treasury, Environmental, Health and Safety.<br>• Feedback of issues is via six-monthly compliance reporting from country managers, and monthly reporting of legal issues by external legal advisers.<br>• Tax positions and relationships with local tax authorities are managed by the Group tax department with oversight from the Board and support from external advisors where appropriate. The Group seeks to maintain adequate support for positions taken and for charges between Group companies. |

Business reviews
## Corporate sustainability and responsibility

# Driving sustainable value creation

AZ recognises that a positive approach to corporate sustainability and responsibility ("CSR") can enhance its reputation and its ability to create and maintain long term value for shareholders. This is why the Board, led by the Chief Executive Officer in this area, takes CSR seriously and is committed to advancing our CSR policies, systems and initiatives across all areas of the business. We make considerable efforts to communicate our CSR activities to all stakeholders, including our shareholders, customers, suppliers, partners and employees.

In support of our core values of integrity, excellence, care, teamwork and commitment, we expect that our business always complies with relevant laws and regulations, and is conducted to high ethical standards, in each of the territories in which we operate. All our employees, agents and business partners are also expected to demonstrate the highest standards of professionalism and integrity when conducting business on our behalf.

The following section summarises our approach to CSR and our performance during 2012.

### Our CSR definition and commitments

Our definition of CSR encompasses:

- excellent health and safety and employee well-being;
- strong environmental performance, including developing products that minimise the use of environmentally harmful materials;
- continuous operational improvement;
- outstanding production and quality control;
- strong business continuity management; and
- support for our communities.

"

Creating a business that is sustainable in the long term includes playing a positive role in society and the communities in which we operate. At AZ, we believe that if we do this properly, it can also make a positive contribution to innovation and growth.

Geoff Wild
Chief Executive Officer

### Environmental Safety, Health & Security policy

The environmental, safety, health and security ("ESH&S") aspects of CSR are formalised in our Group ESH&S policy, which confirms that AZ will provide a safe and healthy workplace for employees and visitors, and seek to minimise the environmental impact of our operations and products.

In this respect, we are committed to continuous improvement and achieving our ESH&S goals by:

- implementing systems and procedures which meet the intent of ISO 14001 (Environmental Management Standard) and OHSAS 18001 (Occupational Health & Safety Standard);
- adopting best practices which are beneficial to the business;
- ensuring that all applicable local and national regulations are met; and
- reducing our environmental impact by implementing "green" practices.

**Pursuing our CSR objectives and following our ESH&S policy allows us to make clear commitments to our stakeholders:**

1. **To our Customers:** We commit to scientific excellence and investment in research and development to provide innovative, high quality products aligned with our customers' emerging requirements.
2. **To our Employees:** We embrace a diverse workforce and inclusive culture. The health, safety, professional development, work-life balance and equitable, respectful treatment of our employees are among our highest priorities.
3. **To our Communities:** We promote conscientious citizenship that improves health and promotes sustainability in our communities.
4. **To our Shareholders:** We strive to deliver long term sustainable growth and shareholder value.
5. **To our Environment:** We encourage the preservation of natural resources and endeavour to minimise the environmental impact of our operations and products.


## How we manage CSR

We continue to develop our approach to CSR and to integrate environmental, health and safety ("EHS"), and social and economic factors into our policies, practices and operations.

We aim to comply with all EHS laws, rules and regulations that apply to our business, which includes having all environmental permits and licences that our operations require.

We have a Global Environmental, Safety and Health Affairs ("ESHA") Council which is responsible for:

- our EHS and security policies, and our compliance with them;
- monitoring and implementing applicable regulations; and
- ensuring we achieve uniformity and share excellence across the Group in these key areas.

The Global ESHA Council includes representatives from each site and meets as a collective body at least once a year. The Global ESHA Manager reports monthly on Group EHS performance to the Global Management Team ("GMT").

Local ESHA Managers chair regular site meetings to review and coordinate their own programmes of practical compliance with the laws, rules and regulations applicable to their site, and to ensure we fully integrate our Group ESH&S policy into local business strategy.

Through local meetings and communications, our employees are constantly reminded of our ESHA goals and the Group's zero tolerance target of "0-0-0" – meaning Zero Lost Working Day Cases, Zero Recordable Incidents and Zero Reportable Environmental incidents. In 2012, our performance was 2-4-0 (2011: 1-2-1) and this is explained further in the body of this Report.

## Health and safety

Maintaining the health and safety of employees and visitors to our premises is our top priority.

### Our approach

Each site has its own Health and Safety Committee, which organises local accident-prevention activities. The Global ESHA Council helps sites to share information and also oversees various programmes and initiatives. Our employees undergo continuous training and take part in simulations and drills in accordance with carefully formulated plans, and we have procedures to ensure we respond quickly and effectively to any accident or incident.

We conduct audits, investigations and checks to test our safety measures and continually work to improve them. These audits cover our production plants and other technical facilities, inventory and laboratories. Any changes required are agreed with local management and then implemented.

Safety and risk management audits are also regularly conducted at our locations by third-parties, including insurers. These inspections identify the potential for improvement and are a vital accident prevention tool. Recommendations are implemented wherever possible.

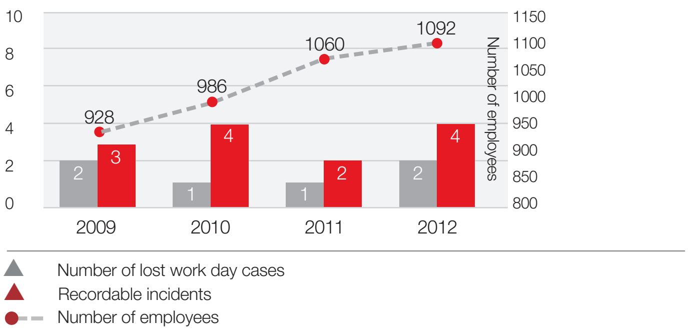
### Accreditations

All of our production facilities are certified to the internationally recognised Occupational Health and Safety Assessment Series (OHSAS) 18001 standard or equivalent.

### Performance

As part of our Group "0-0-0" tolerance target, we aim to achieve zero lost working day cases and zero recordable incidents. In 2012, our performance was 2-4 (2011: 1-2) and our record remains well below the average incident rate for the chemical industry.

**Lost work day cases and recordable incident rate**



Business reviews

# Corporate sustainability and responsibility continued

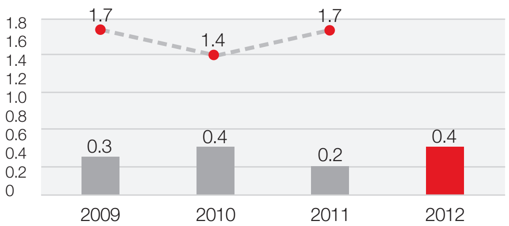
## 0.4

The number of incidents per 200,000 hours worked across the Group

However, we were disappointed with our performance in 2012. Each of the incidents was thoroughly investigated, which confirmed that none were due to a failure in our safety structure, systems or procedures, which remain strong, and that all were avoidable as they were based on individual behaviour issues. In response, and recognising the risk of complacency when performing repetitive tasks, a Group-wide and high profile programme led by the GMT was launched and communicated to all employees. This comprised increased awareness and training, more regular spot-checks, more frequent walk-throughs and a local initiative aimed at driving an increased sense of urgency when it comes to safety.

The chart below shows our global incident rate, which is the number of incidents per 200,000 hours worked, and compares our performance with one measure of industry performance, which is sourced from the American Chemical Society.

### Global incident rate




AZ incident rate

American Chemical Society average (data for 2012 not yet available)

Note:
An incident occurs if a work-related injury or illness results in death, days away from work, restrictions on the work an employee can perform, transfer to another job, medical treatment beyond first aid or loss of consciousness.

## Environmental

A key priority for AZ is to ensure that our products pose no risk to people or the environment when they are used as intended.

### Our approach

Our approach is set out in our product stewardship strategy, which is to:

1. Use product safety reviews along the entire supply chain;
2. Achieve transparency through our SAP database, which contains constantly updated environmental, health and safety information on our substances and products;
3. Adopt global directives, with uniformly high product safety standards worldwide; and
4. Maintain the Globally Harmonised System of Classification and Labelling of Chemicals.

This strategy means that product stewardship does not end at the factory gates. We deliver consistently high product stewardship standards worldwide, which often go well beyond our legal requirements.

In particular, we:

- inform our customers and the public about the properties of our substances, with the help of our SAP database;
- make available safety data sheets on all our products, in at least 15 languages;
- provide information around the clock, through our emergency hotlines; and
- train our customers, when needed, in the safe handling and use of our products.

Throughout our manufacturing processes, we use many substances which can be hazardous. We are therefore subject to environmental laws and regulations in each jurisdiction in which we operate or transport materials through. These govern a range of aspects, including:

- air emissions;
- waste water discharges;
- storage, use and handling of hazardous substances;
- waste disposal; and
- health and safety of employees.

# 739,000

The number of shipments of returnable containers

We are required to hold valid permits or licences for operations that discharge to land, air and water, as well as for the use and handling of waste and other hazardous materials. All permits and licences are in place and establish specific limits and standards for our operations.

## Accreditations

All of our production sites are certified to comply with the ISO 14001 environmental management standard.

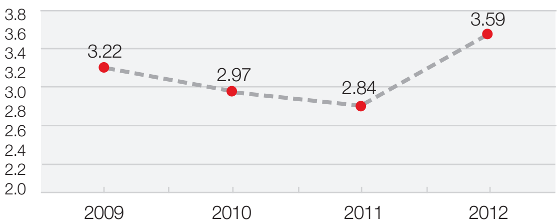
## Performance

As part of our “0-0-0” tolerance target, we aim to achieve zero reportable environmental incidents. We achieved this in 2012 (2011: 1).

AZ’s production processes do not directly result in any carbon dioxide emissions – our only emissions come indirectly from the energy we consume.

## Energy consumption

(kWh/kg of production)

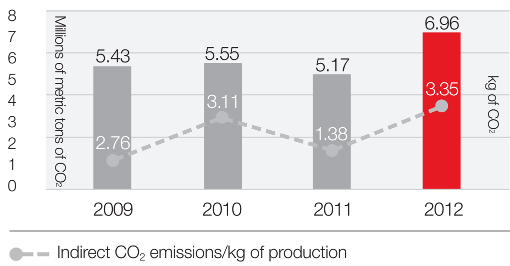



Our energy usage increased in 2012 which caused our efficiency measure to deteriorate to 3.59 kWh per kg of material produced (2011: 2.84 kWh). This was the result of:

- our investing in a number of state-of-the art clean rooms, which need to be operated continually throughout the year;
- the completion of two plant expansions in Taiwan and South Korea. These consumed significant amounts of energy in the construction and commissioning stages and full scale production at both facilities will commence in 2013. The Korean facility also includes a refrigerated warehousing unit and this will increase ongoing energy usage going forward; and
- a change in product mix resulting in more energy consuming products, such as Klebosol®, being produced.

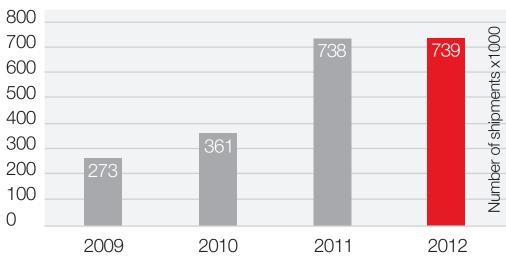
With the Group’s energy consumption increasing in 2012, as explained above, there was a knock-on increase in our indirect $CO_2$ emissions from 5.17 to 6.96 million metric tons. This, together with the reduction in production, increased the $CO_2$ emissions per kg of production to 3.35 kg (2011: 1.38 kg).

## $CO_2$ emissions (indirect)




During 2012, our shipments of material using returnable containers were slightly above the levels experienced in 2011, reflecting a similar revenue performance year-on-year. We continue to invest in and use returnable containers wherever it is practical and efficient to do so.

## Returnable container shipments



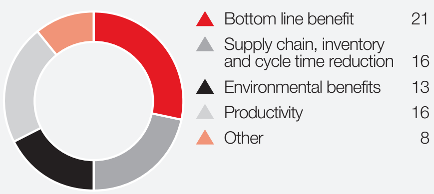

In Europe, the second registration deadline under the Registration, Evaluation, Authorisation and Restriction of Chemical Substances – EC1907/2006 regulations (“REACH”) takes place in June 2013. This requires the registration of all substances produced or imported in quantities of between 100 and 1,000 metric tons per year. We have already provided our suppliers with the data required for them to meet this deadline. We have also begun preparing for the final stage of REACH which will require the registration of chemicals produced or imported in quantities of between 1 and 100 metric tons per year and has a deadline of 2018.

We have been monitoring the mandatory reporting requirements in relation to greenhouse gas emissions, which are expected to be introduced under new regulations in 2013 and apply to AZ as a London Stock Exchange listed company from next year. In anticipation, we are reviewing the Group’s key performance indicators in this area, as well as our monitoring and reporting procedures, so we are in a position to make full disclosure in a timely manner.

Business reviews

# Corporate sustainability and responsibility continued

## LSS improvement projects 2012




74

The number of Lean Six Sigma projects completed in the year

## Operational excellence

To remain competitive and deliver profitable growth, we need to be as effective and efficient as possible in everything we do. This means continually improving the way we work, having the right organisational structure in place and successfully managing risk. Our efforts enable us to enhance our productivity and quality, and reduce our costs.

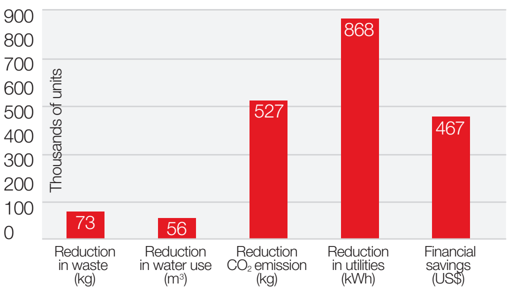
### Our approach

AZ uses Lean Six Sigma (LSS), an internationally recognised methodology, to drive its continuous improvement programme. This aims to deliver improvements, reductions and cost savings in areas such as productivity, processes, cycle time, energy and utility consumption and environmental matters. Almost 10% of our workforce is qualified as LSS black or green belts, reflecting their levels of competence and experience. Each site identifies its own specific LSS projects and best practice is shared across the Group.

### Performance

Our LSS approach has resulted in considerable financial savings in recent years. During 2012, we completed 74 LSS projects across the Group (see above chart) generating annual cost savings of some US$6m. Thirteen of the projects included environmental targets and the chart below shows the reductions in waste production, water, carbon dioxide emissions and utilities, and the US$0.5m annual cost savings which resulted from them.

## Environmental savings from Lean Six Sigma




Our LSS approach also delivers significant qualitative benefits, including:

- to the customer, through higher delivery performance,
- to the environment, through reduced waste; and
- to the Group, through improved productivity, communication and planning.

## Supply chain

AZ is a critical player in the electronics supply chain, which is an extremely competitive market. Our customers need high manufacturing yields to maintain profitability, and we help make this possible by securing quality of supply and delivering products of the highest purity and performance. Failing to deliver this on a consistent and reliable basis could seriously damage our reputation and our customer relationships. We therefore continue to make sizeable investments in the right people, processes and equipment, to ensure we meet our customers' requirements every time, on time.

### Our approach

Producing the highest quality products requires high-purity raw materials, stable process design and a robust quality assurance programme. Even minor raw material impurities could result in:

- a substantial amount of defective product;
- disruption to our production processes;
- significant repair or modification costs; or
- delayed shipping.

We operate a robust supply chain and procurement policy and in applying this we have developed close relationships with the specialty chemical suppliers who produce our key raw materials. Our vendor qualification process involves a rigorous lot-to-lot sampling and on-site audit programme, which verifies the quality system and sets a timeline for any required improvements. Once a vendor is qualified, we regularly audit their quality and business continuity plans to ensure they maintain the highest standards and have in place an achievable recovery plan if an incident interrupts the supply of raw materials.

Additionally, and wherever possible, we look to reduce the length of the supply chain by sourcing and producing close to our customers.

### Performance

In 2012, we invested significant time and resources in improving our procurement processes throughout the Group. This resulted in our securing alternative sources of supply for as many raw materials as possible and enhancing our contract negotiation framework and procedures.

During the year, a major event at an upstream supplier's chemical plant in Japan resulted in a shortage of cresol resin material that our Optronics Division uses for photoresist production. As a direct consequence of our dual sourcing and security of supply programme, we were able to immediately source a replacement raw material from an alternative supplier avoiding any disruption in supply to our customers. We also gained commercial advantage by winning new business from our competitors who struggled to source alternative supplies.

In the second half of 2012, we also consolidated our multiple freight forwarder carriers into just three suppliers who between them can meet our global logistic requirements. The cost saving and improved efficiency arrangements have been implemented from the start of 2013.

99.7%

Our ontime delivery performance

## Quality control

Delivering the highest levels of product quality and customer satisfaction is critical to us. Our reputation is built on it.

To give customers the comfort they need on the quality of our products, they require us to go through a product qualification or certification process, which can take between 6 and 18 months. This includes deploying state-of-the-art measurement equipment across all of our production facilities. Some customers also assess our manufacturing processes against their own quality standards.

### Our approach

We have implemented a Group-wide quality management system through our Global Quality Council which applies to all management, processes and services at our production facilities. The system also allows us to share information, expertise and best practice to ensure consistent quality and service to all our customers throughout the world.

We carry out our own quality tests before delivering products to customers and control the quality of products manufactured by third-parties by ensuring they comply with our standards of excellence. A certificate of specification compliance is issued to customers for each batch produced, whether that is for products produced at an AZ site or a third-party site.

### Accreditations

The quality control programmes at our production sites are registered to the ISO 9001 quality management standard. The registration process involves periodically reviewing our manufacturing processes and quality management systems. In addition, our French site complies with ISO/TS 16949.

### Performance

We aim to achieve zero complaints about the quality and delivery of our products. During the year, we once again maintained our excellent quality and ontime delivery performance, as shown in the table below.

### Quality and ontime delivery

| | 2009 | 2010 | 2011 | **2012** |
|---|---|---|---|---|
| Complaints relating to the quality of our products | 0.2% | 0.2% | 0.2% | **0.2%** |
| Ontime delivery rate | 99.5% | 99.8% | 99.8% | **99.7%** |

## Business continuity management

We are a critical supplier to our customers and any fulfilment failure could interrupt their businesses and significantly affect our financial performance and reputation. That is why business continuity planning forms such an important part of our risk management framework.

### Our approach

We have developed a business continuity management system across the Group to help mitigate the risk in this important area and allow us to immediately respond to and effectively manage any incidents. Each operating site has its own business continuity plan ("BCP") which defines the actions needed to recover operations within a set time after an incident. We test our BCPs at least annually, simulating events at each manufacturing site and assessing the event's potential impact on customers.

We have a global network of suppliers. Since our supply chain is integral to our business continuity management, we also educate our key suppliers and encourage them to deploy their own business continuity management system.

### Performance

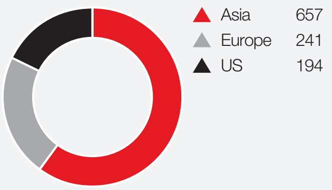
Our BCP system once again proved its worth in 2012. Hurricane Sandy hit the East Coast of the United States on 29 October, severely affecting our Branchburg site in New Jersey. The storm caused local flooding, took out power supplies and disrupted transportation. None of our employees were injured but our Branchburg site was without power for four days. Our local BCP was immediately triggered as we established a remote command centre with the primary task of ensuring that all our employees could be located and were safe. Emergency generators provided power to the site's critical IT and security systems, and the management team was in constant communication, feeding updates to employees via our emergency 800 telephone number and keeping customers informed of our actions to fulfil their orders. Our BCP proved extremely successful, as all customer order commitments were met.

While our Branchburg site was fully operational after just four days, the local community took a little longer to recover from the storm. After returning to work, our employees played their part in helping the local community and residents to recover (see Communities on page 45).

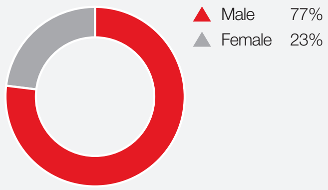
# Business reviews
## Corporate sustainability and responsibility continued

### Employee headcount – by activity
at 31 December 2012


### Employee headcount – by geography
at 31 December 2012




### Gender diversity
at 31 December 2012




## Employees

AZ is a people-critical business. We rely on our employees to be innovative, ambitious and passionate about driving our business forward, so we are creating a stimulating work environment in which they can apply their skills and share in the success they help to create.

### Our approach
Our recruitment practice seeks to balance the commitment and loyalty which come from internal appointments, with the need for change and fresh ideas which come from external appointments. We also believe in "acting locally", which is why our employment policies are designed to reflect regulatory, cultural and local market requirements. The majority of our employees' salaries are set in line with local market practice and we pay at least the minimum wage required by local law and collective agreements.

We maintain excellent relationships with our employees. We uphold their right to choose which organisations they join and whether or not to unionise. We recognise and safeguard human rights in all the countries in which we operate. At the same time, we respect the sovereignty of nations and affirm their primary responsibility to protect their citizens' human rights. We seek to do business with partners, customers, suppliers and contractors who share our commitment. We oppose the use of child or forced labour and expect our customers and suppliers to do the same.

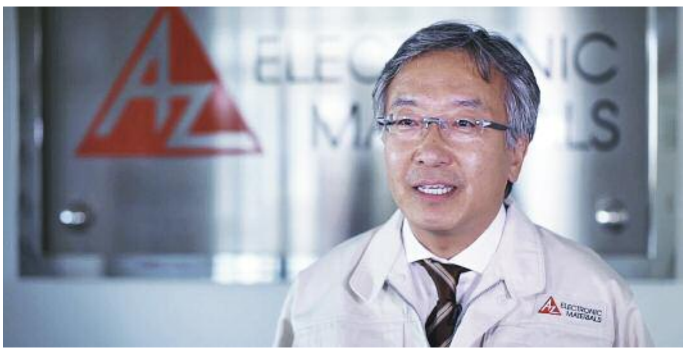
Our goal is to create a culture and environment in which all employees feel valued, respected, inspired and included. AZ does not condone unfair treatment of any kind and is committed to providing equal opportunities to existing and prospective employees in all aspects of employment and advancement regardless of gender, ethnicity, nationality, disability, age, marital status, sexual orientation, religious or political beliefs.

We recognise talent and are committed to helping our employees to realise their full potential through ongoing training and development.

### Performance
We successfully introduced a ShareMatch Plan in 2012 to provide employees with an opportunity to share in our success through AZ share ownership. The plan was open to employees across the Group and 31% of eligible employees participated in the inaugural invitation.

During the year, 40 of our key project managers from all over the world attended a five-day Project Management Bootcamp to learn current best practices and receive coaching from industry experts. This is part of an ongoing programme to improve our project management skills and capabilities throughout the business.

Further details about our employees, their performance during the year, and the initiatives which are under way, are set out in 'People, our assets' on page 22.



# US$10,000

The amount raised by AZ and its employees in New Jersey to support the local community

## Communities

AZ aims to be a responsible corporate citizen and recognises the importance of being an active employer in the local communities in which it operates.

### Our approach

Each site manages its own community activities and needs, allowing them to effectively target and support events and initiatives on a local basis.

We also take action to protect the safety of local residents and, where necessary, we involve communities in preparing emergency response plans for our production facilities.

### Performance

Throughout 2012, our sites have participated in community events that have led to increased exposure to and knowledge of AZ and its operations. For example:

- our employees in Branchburg, New Jersey, continued to support their local branch of the United Way, a non-profit organisation that tackles community problems. This year, a team of AZ volunteers gave up their own time to organise a fundraising campaign in which all other employees participated. As on previous occasions, the event was themed to communicate the needs of the community and prizes for the fundraising were donated by local businesses. This year, with a 25% match by AZ, our employees raised approximately US$10,000. They also assisted victims of Hurricane Sandy, which had a devastating impact on the State of New Jersey, by raising funds for the American Red Cross and collecting both food and cleaning items that were donated to a local food bank; and
- our employees in Korea formed a volunteers club called 'OnNuriae' (which translates as "Love is Everywhere") which provides help to the local community. During the year, the club performed a number of community support tasks, including helping to prepare meals during the winter season for senior citizens living alone; raising donations for children from low income families to attend field trips (where our employees also acted as volunteers); providing gifts on Children's Day; and helping to clean up neighbouring areas. In recognition of their community work during the year, the club were presented with an Achievement (Contribution) Award from the Mayor of Anseong.

Our emergency response plans seek to reduce both the short term and long term impact of disasters on our plants and their local communities. Testing these plans gives comfort to the local communities that we can react appropriately in the event of an incident at or near to our facilities, to minimise the impact on them. During the year, a number of our plants, including those in France, Japan and Taiwan, participated in a major incident simulation exercise in which the sites' disaster response plans are tested alongside those of neighbouring companies. At all sites, our evacuation and containment plans proved to be effective.

An example of such an event was the Big Platform Disaster Drill held at our plant in France, where we share site infrastructure facilities with Clariant and PQ. The disaster scenario simulated was a toxic gas leakage at the site which required 100 firemen, 30 policemen and 25 medical personnel to respond. The event received positive feedback from the French authorities, including local government officials and representatives from neighbouring schools, who observed the event. Of particular note was the coordination of the overall programme and the effectiveness of our communication, which included the use of the local radio station. The suggestion to support the siren alarm system with an automated telephone system has already been implemented.

> "AZ aims to be a responsible corporate citizen and recognises the importance of being an active employer in the local communities in which it operates.

Governance
**Board of Directors**

# A strong and experienced Board

“AZ has established a strong Board with each Director bringing their own expertise, knowledge and abilities gained from across a broad range of business sectors. The Non-Executive Directors represent a robust independent element of the Board bringing sound judgment and objectivity to its deliberations and decision-making process, helping to constructively challenge and support the Executive.

John Whybrow
Chairman

**John Whybrow** (65) R(C) N(C)
**Chairman: Independent Non-Executive Director**

Appointed to the Board: 2010

**Skills and experience:** Mr Whybrow has significant experience of the semiconductor and consumer electronics industries and of serving as Chairman on the boards of major public companies.

He was previously Chairman of Wolseley plc (2002 – 2011), having joined that company's board in 1997, Chairman of CSR plc (2004 – 2007), and a non-executive director of Dixons Group (2003 – 2010). Prior to that, Mr Whybrow was President and Chief Executive Officer of Philips Lighting BV, based in the Netherlands, until 2000 and Executive Vice President of Philips Electronics NV from 1998 to 2002 when he returned to England. He received the Polish Order of Merit in 2002.

**Current other appointments:**
Chairman, Petworth Cottage Nursing Home

Member of Council of the Royal National Lifeboat Institution

**Geoff Wild** (56)
**Chief Executive Officer**

Appointed to the Board: 2010

**Skills and experience:** Mr Wild, who joined AZ as Chief Executive Officer in January 2010, has extensive managerial experience in global, high technology electronics and materials businesses.

He began his career in the electronics materials division of Johnson Matthey where he worked for 17 years until 1997. He went on to become President of AlliedSignal Inc's (now Honeywell) electronic materials division (1997-2000), CEO of TheSupply, an internet-based logistics company (2000 – 2002), CEO of Nikon Precision Inc (2002 – 2007), and then CEO and President of Cascade Microtech Inc (2008 – 2009). All of these businesses are in the semiconductor and electronic materials industry. He has also served as a non-executive director of E-Ink Corporation until December 2009 and of Axcelis Inc until April 2011.

**Current other appointments:**
Materion Corporation, USA (non-executive director)

**Mike Powell** (45)
**Chief Financial Officer**

Appointed to the Board: 2011

**Skills and experience:** Mr Powell has considerable experience and a strong record of achievement in global financial management, business strategy, performance and change management, and of working in Asia where the vast majority of AZ's operations are situated.

He joined AZ in August 2011 and was appointed to the Board as Chief Financial Officer in September 2011. He is a member of the Chartered Institute of Management Accountants. For the five years prior to joining AZ, Mr Powell was Group Finance Director of Nippon Sheet Glass Co Ltd ("NSG Group"), a large multinational company listed on the Tokyo Stock Exchange and a Nikkei 225 participant. Prior to that, he had started his career as a graduate with, and spent 15 years at, Pilkington plc, a FTSE 250 company which manufactures glass products for the building and automotive industries. While there, he held a variety of senior finance roles, including UK Finance Director of Pilkington's Primary Products Division and VP of Pilkington Australasia. Pilkington plc was acquired by NSG Group in 2006 and Mr Powell was later appointed Group Finance Director of the combined business.

**Current other appointments:**
None

**Andrew Allner** (59) A(C), R, N
**Senior Independent Non-Executive Director**

Appointed to the Board: 2010

**Skills and experience:** Mr Allner, who was appointed Senior Independent Director with effect from 1 January 2012, has extensive public company board experience in both executive and non-executive positions.

He has a financial background and is a Fellow of the Institute of Chartered Accountants in England and Wales. Mr Allner was Group Finance Director of RHM plc (2004 – 2007), taking a lead role in its flotation on the London Stock Exchange in 2005. Prior to that, he was CEO of Enodis plc. He has also served in senior positions with Dalgety plc, Amersham International plc and Guinness plc. He is a former partner of Price Waterhouse and a graduate of Oxford University.

**Current other appointments:**
Marshalls plc (non-executive Chairman)

Fox Marble Holdings PLC (non-executive Chairman)

The Go-Ahead Group plc (Senior Independent Director, Chairman of the Audit Committee and, with effect from 25 April 2013, non-executive Chairman)

CSR plc (non-executive director and Chairman of the Audit Committee)

Northgate plc (non-executive director and Chairman of the Audit Committee)

**Gerald Ermentrout** (64) R, N
**Independent Non-Executive Director**

Appointed to the Board: 2010

**Skills and experience:** Mr Ermentrout brings to the Board many years of experience in the global electronic chemicals industry having held both executive and non-executive director positions in USA-based international businesses.

He spent 31 years with Air Products Inc which included serving as Vice President and General Manager until his retirement in 2007.

**Current other appointments:**
KMG Chemicals Inc, USA (non-executive director)

**Adrian Auer** (64) A, R, N
**Independent Non-Executive Director**

Appointed to the Board: 2011

**Skills and experience:** Mr Auer brings extensive and relevant non-executive experience, as well as a significant financial skills-set developed through senior financial roles held at several multinational listed companies.

He has previously held the position of Finance Director in a number of major companies, notably in the building materials and construction sectors, as well as senior finance positions with BP and ICI.

**Current other appointments:**
Shanks Group plc (non-executive Chairman)
Electrocomponents plc (non-executive director)
Addaction (Chairman of the Board of Trustees)

**Dr David Price CBE** (57) A, N
**Independent Non-Executive Director**

Appointed to the Board: 2011

**Skills and experience:** Dr Price brings to the Board an understanding of the nature of an international research and development-led business with diverse, highly technical operations.

He was Chief Executive of Chemring Group PLC, a FTSE 250 defence and aerospace company, until 23 October 2012. Previously, Dr Price spent five years as Managing Director of the naval marine business of Rolls-Royce plc, served as Managing Director for the UK business of Thomson-CSF (1998 – 2000), and was Chief Executive of Thomson-Thorn Electronics (1995 – 1998). He is a fellow of the Institute of Engineering & Technology, the Royal Aeronautical Society and the Institute of Marine Engineering, Science & Technology.

**Current other appointments:**
Member of Council at Southampton University

**Philana Poon** (45) R, N
**Independent Non-Executive Director**

Appointed to the Board: 29 June 2012

**Skills and experience:** Ms Poon has a wealth of business experience in Asia, where the vast majority of AZ's operations are situated, having advised boards extensively on commercial, risk and transaction matters.

She has over 15 years' experience in the technology and telecommunications industries since joining Hong Kong Telecommunications Limited in 1998. She was Group General Counsel of PCCW Limited (2004 – 2011), and Company Secretary of PCCW Limited (2007 – 2011). Since November 2011, she has been Group General Counsel and Company Secretary of the HKT Trust and HKT Limited, and since August 2012, Group Company Secretary of PCCW Limited. Prior to 1998, Ms Poon was in private practice at Lovells and at Baker & McKenzie, both in Hong Kong.

**Current other appointments**
Member of the Hong Kong General Chamber of Commerce Legal Sub-Committee

Key:
A Audit Committee
R Remuneration Committee
N Nominations Committee
(C) Chairman of the Committee

## Global Management Team ("GMT")

The GMT is a decision making forum which meets monthly. It operates under the direction and authority of the Chief Executive Officer and comprises senior management members from across the business. Its primary role is to implement the Board's objectives and policies, address key operational issues and manage the day-to-day performance of the business.

**Geoff Wild**
**Chief Executive Officer**

**Mike Powell**
**Chief Financial Officer**

**Dr Rico Wiedenbruch**
**Managing Director, IC Materials Division**

**Anand Nambiar**
**Managing Director, Optronics Division**

**Dr Michael Meier**
**Head of Group Operations**

**Dr Brian Daniels**
**Global R&D Director**

**Dr Ralph Dammel**
**Chief Technology Officer**

**Daniel Wan**
**Group Human Resources Director**

**Michael Arnaouti**
**Company Secretary**

Governance
# Directors' report

The Directors have pleasure in presenting their report, which constitutes the management report ("Management Report") as defined by Luxembourg Law, together with the audited consolidated financial statements and annual accounts as at 31 December 2012, and for the accounting period then ended. As permitted by Luxembourg Law, the Directors have elected to prepare a single Management Report covering both the Company and the Group.

## Principal activity and business review

The principal activity of the Group is the provision of high quality, high-purity, specialty chemical materials to manufacturers of integrated circuits ("ICs") and flat panel displays ("FPDs"). The Group's products enable the manufacture of ICs and FPDs that are integral to a wide variety of electronic devices and applications including computers and tablet devices, flat screen televisions, mobile communication devices, industrial and automotive applications and the developing light-emitting diode ("LED") and energy markets. AZ operates in 10 countries, namely China, France, Germany, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and the USA, It also has support services offices in Hong Kong and the United Kingdom and a corporate office in Luxembourg.

A review of the Group's performance during the year, and its position at the year end, including commentary on its financial position, principal risks and uncertainties, key performance indicators and likely future development and prospects, is set out on pages 4 to 7 and 26 to 37 should be read in conjunction with this Report. The Corporate Sustainability and Responsibility Review on pages 38 to 45 summarises the Group's approach to business ethics, employee welfare and practice, health and safety and environmental matters.

In November 2012, the Group revised its management structure and control which is now based on two operating divisions, namely, IC Materials and Optronics. As a result, with effect from 1 January 2013, the Printing & Other Division (which since IPO in November 2010 was managed and reported as a separate segment) has been absorbed within the IC Conventional business of the IC Materials Division.

This Annual Report contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group. By their nature, these statements involve risks and uncertainties since future events and circumstances can cause results and developments to differ from those anticipated. These forward-looking statements reflect knowledge and information available at the date of preparation of this Annual Report and the Company undertakes no obligation to update such statements.

## Company status

AZ Electronic Materials S.A. (RCS Luxembourg: B156074) was incorporated on 12 October 2010 as a public limited liability company (Société Anonyme) under the laws of the Grand Duchy of Luxembourg and has, since incorporation, been the holding company of the Group. The Company has held a premium listing on the London Stock Exchange's main market for listed securities since 3 November 2010. It is expected that the Company (which has no branches) will continue to operate as the holding company of the Group for the foreseeable future.

## Results and dividend

The consolidated financial statements of the Group and the annual accounts of the Company for the accounting period under review are set out on pages 75 to 113 and 116 to 121 respectively.

The Directors' intention is to maintain a capital structure that is efficient in terms of providing long term returns to shareholders, with sufficient cash flow available to meet the organic growth requirements of the business, to reduce debt further and to provide an income stream to shareholders via a dividend. The Board announced an interim dividend for 2012 of 4.0 cents per Ordinary share which was paid in October. The Board is now recommending a final dividend of 9.1 cents per Ordinary share. A resolution to approve a total distribution by the Company for the year ended 31 December 2012 of 13.1 cents per Ordinary share from available distributable reserves in respect of the interim and final dividends will be put to shareholders at the Annual General Meeting to be held on 24 April 2013. The final dividend, if approved, will be paid on 3 May to shareholders registered at the close of business on 15 March 2013.

Carey Pensions and Benefits Limited, a shareholder who acts as the trustee of the Company's off-shore discretionary Employee Benefit Trust ("EBT"), has waived its right to receive all and any dividends on the AZ Ordinary shares it holds in the EBT from time to time.

## Events since the balance sheet date

There have been no material post-balance sheet events.

## Research and development

The IC and FPD industries are characterised by rapid technological change. Accordingly, the Group believes that research and development ("R&D") is critical to its success and central to its strategy to achieve growth by developing and producing value-added products to the electronics industry. The Group maintains a strong R&D and technology platform that enhances its ability to develop leading-edge products to drive future growth in its business and provide technical support to its customers. From the beginning of 2012, we restructured our operations to provide for the central management of R&D and Intellectual Property ("IP"). This will allow the Group to achieve further operational benefits and help optimise the rate and pace at which our significant investment in R&D flows through into new product revenue and valuable IP. Further details of the Group's R&D activity are given on pages 18 to 21.

The Group's commitment to this important area is highlighted by the US$55.8m of R&D spend during the year, equivalent to 7.0% of Group revenue (2011: US$54.0m and 6.8%). R&D costs have been fully expensed in the Group's consolidated income statements as the costs do not meet the strict capitalisation criteria under IAS 38 "Intangible Assets" at the time such costs are incurred.

The Company, on a standalone basis, has not itself conducted any activities in the areas of research and development.

## Financial instruments

The Group concluded the refinancing of its debt facilities on 7 December 2012 with the establishment of new facilities totalling approximately US$500m and comprising US$125m and €45m of amortising term debt and a US$315m revolving credit facility with a final maturity of April 2017. The new facilities, which have been made available to the Company and certain of its subsidiaries acting in the capacity as borrowers and/or guarantors, have been syndicated to a group of UK and international banks. Further details are provided in the Financial Review on page 32.

Details of the Group's objectives and policies on financial risk management, and of the financial instruments currently in use, can be found in Note 26 to the consolidated financial statements.

## Share capital

At 31 December 2012, there were 380,913,552 Ordinary shares in issue and fully paid, with no new shares having been issued during the year. Further details relating to share capital are set out in Note 20 to the consolidated financial statements.

In common with the Articles of Association of other Luxembourg public limited companies, the Company's Articles of Association ("Articles"), provide full power to the Board to issue shares on a non pre-emptive basis. However, as a matter of good practice, the Board intends to comply with the pre-emption guidelines supported by the Association of British Insurers and the National Association of Pension Funds to the extent practical for a Luxembourg company. A resolution to that effect will be proposed at the Company's Annual General Meeting to be held on 24 April 2013 ("2013 AGM").

At 31 December 2012, the EBT held 1,269,114 Ordinary shares of US$0.10 each in the Company. These shares, which were purchased at the Company's request using some £5m of unallocated cash in the EBT, are held for the purpose of satisfying the future vesting of awards under the Company's employee share incentive plans as detailed below. The Company's authorised but unissued share capital is US$53,908,645 divided into 539,086,448 Ordinary shares.

## Shareholder rights

The Company has a single class of share which is divided into Ordinary shares of US$0.10 each, all ranking pari passu. No other securities have been issued by the Company. Except in relation to distributions which may be declared or rights arising on a liquidation of the Company, the shareholders have no rights to share in the profits of the Company. The Ordinary shares are not redeemable. Ordinary shares may be purchased by the Company subject to shareholders' prior approval, Luxembourg Company Law and the requirements of the Listing Rules and any applicable securities laws.

Each shareholder is entitled to vote at general meetings of the Company. Unless otherwise provided by Luxembourg Company Law, all decisions taken at an annual or general shareholders' meeting shall be by a simple majority of the votes cast, regardless of the proportion of the capital represented by shareholders in attendance at the meeting. The rights (including full details relating to voting), obligations and any restrictions on transfer relating to the Company's Ordinary shares, as well as the powers of the Directors, are set out in the Articles. These can only be amended at an extraordinary shareholders' meeting where at least one half of the issued share capital is represented and when adopted by at least two-thirds of the votes cast.

Save as described under the Lock-up Arrangements referred to below, the Company is not aware of any agreements or control rights between existing shareholders that may result in restrictions on the transfer of securities or on voting rights.

## Board of Directors

The names and brief biographical details of the current Directors, and the identification of the Board Committees of which they are members, are shown on pages 46 and 47.

Messrs Whybrow, Allner, Ermentrout, Price, Auer, Wild and Powell each served as Directors throughout the year. Mr Adrian Whitfield resigned as a Director on 25 May and Ms Philana Poon was appointed as a Director in his place on 29 June 2012.

## Appointment and re-election of Directors

The Articles contain provisions relating to the appointment and re-election of Directors who must be appointed to office by shareholders in general meeting for a term not exceeding six years. If no duration is specified, the term shall be deemed to be for one year. Shareholders may remove a Director at any time, including before the expiry of their term of office, by Ordinary resolution and may by Ordinary resolution appoint another person who is willing to act as a Director in their place.

Notwithstanding the above, and in line with best governance practice, the Board's intention is that all Directors will seek re-election to office each year at the Annual General Meeting of the Company. Therefore, all serving Directors will retire at the 2013 AGM. Further details of appointments to the Board and re-election can be found in the Corporate Governance Report on pages 53 to 59.

The Service Agreements of the Executive Directors and the Letters of Appointment of the Non-Executive Directors are available for inspection by shareholders at the Company's registered office during normal business hours. Brief details are also included in the Remuneration Report on pages 64 to 73.

## Directors' Interests

Details of the Directors' interests (including those of their immediate families and any connected persons) in the issued share capital of the Company at 1 January 2012 or, if later, their date of appointment and at 31 December 2012 are set out below:

| | 1 January 2012 (or date of appointment, if later) Number of AZ Ordinary shares | 31 December 2012 Number of AZ Ordinary shares |
|---|---|---|
| John Whybrow[1] | 78,541 | 78,541 |
| Geoff Wild | 891,749 | 845,749 |
| Mike Powell | – | 26,934 |
| Andrew Allner[1] | 26,179 | 26,828 |
| Gerald Ermentrout | 27,486 | 27,486 |
| Adrian Whitfield[2] | – | n/a |
| Adrian Auer | – | – |
| David Price | 4,000 | 4,000 |
| Philana Poon[3] | – | – |

1. The share interest held by each of Messrs Whybrow and Allner is subject to certain ongoing restrictions as to the timing by which they can deal in certain shares under their respective obligations under the Lock-up Deed, as defined and explained below in Lock-up Arrangements.

2. Resigned 25 May 2012.

3. Appointed 29 June 2012.

# Governance
# Directors' report continued

There have been no changes in the Directors' beneficial or non-beneficial interests between 31 December 2012 and 18 February 2013, the date on which this Report has been signed.

Details of Directors' remuneration and interests in Ordinary shares which derive from their employment, are set out in the Remuneration Report on pages 64 to 73.

Save as disclosed:

- none of the Directors, nor any person connected with them, has any interest in the share or loan capital of the Company or any of its subsidiaries; and
- at no time during the year ended 31 December 2012 did any Director hold a material interest, directly or indirectly, in any contract of significance with the Company or any subsidiary undertaking other than in relation to the Executive Directors and their Service Agreements.

## Directors' indemnity arrangements
The Company recognises the potential personal liabilities that the Directors are subject to by agreeing to act as a Board member and believes that it is both fair and reasonable to protect them from innocent error or omission. It therefore purchased and maintained throughout the year Directors' and Officers' Liability Insurance to provide the Directors with indemnity cover which operates in certain circumstances. This does not extend to cover the Directors where it is proved they have acted fraudulently or dishonestly.

## Substantial shareholdings
At 18 February 2013, the Company had been notified of the following material interests of 5% or more in the Ordinary share capital of the Company:

| | Number of Ordinary shares | % of voting rights[1] |
|---|---|---|
| BlackRock Inc | 55,549,132 | 14.58 |
| Threadneedle Asset Management Holdings Ltd | 28,397,402 | 7.46 |
| Prudential plc | 20,025,371 | 5.25 |

1. Total voting rights attaching to the issued share capital of the Company comprised 380,913,552 Ordinary shares each of US$0.10 nominal value.

## Relationship Agreements
Effective from Listing on 3 November 2010, each of The Carlyle Group and Vestar Capital Partners ("Major Shareholders") entered into a relationship agreement with the Company governing the exercise of their rights as Major Shareholders ("Relationship Agreements"). In March 2012, both of the Major Shareholders sold their residual holdings of 5.8% each in the Company. As a result, the provisions of the Relationship Agreements no longer remain in force.

## Lock-up Arrangements
The Company and certain shareholders (including the Major Shareholders, certain Directors and senior managers of the Group, and certain former directors and senior managers of the Group) each agreed at Listing to specific lock-up arrangements in relation to their holdings of Ordinary shares pursuant to the Underwriting and Sponsors' Agreement made between the Company, the Underwriters (being Deutsche Bank AG, London Branch, Goldman Sachs International, UBS Limited, Collins Stewart Europe Limited and Société Générale) and certain shareholders dated 29 October 2010 ("Lock-up Deed").

All such lock-up arrangements expired on the second anniversary of Listing on 3 November 2012, save as follows:

- for so long as each of Mr Whybrow and Mr Allner remains a Board member, they are obliged (except in certain circumstances) to hold an interest of 26,180 and 8,726 Ordinary shares respectively in the Company. These represent the number of shares they were each granted by the Company at nil cost pursuant to the terms of their appointment.

## Corporate Governance
The Company is committed to high standards of corporate governance. Its application of the principles of good governance set out in the UK Corporate Governance Code (published in 2010 by the Financial Reporting Council) and the requirements of article 68bis of the Luxembourg Company Law of 19 December 2002 (as modified), as they relate to the Company for the year ended 31 December 2012, is described in the Corporate Governance Report (which forms part of this Report) on pages 53 to 59.

The Statement of Directors' Responsibilities in respect of the consolidated financial statements and the annual accounts appears on page 52.

## Political and charitable donations
In line with Company policy, no political donations were made during the current or previous financial years. The Group provides active support and participation in local community activities in the territories in which it operates and during the year made donations totalling US$5,000 (2011: US$23,000).

## Policy and practice on payment of suppliers
The Group is committed to maintaining a sound commercial relationship with its suppliers. Consequently, the policy of the Company is to agree terms of payment with a supplier as part of the terms and conditions of contract negotiations which govern each business transaction. Payment is then made pursuant to such terms provided that the goods and services have been supplied in accordance with the agreed contract.

At 31 December 2012, the trade creditors of the Group represented 35 days of annual purchases (2011: 40 days), based on the average daily amount invoiced by suppliers during the period.

## Employee share incentive plans
The Company operates a Long Term Incentive Plan ("LTIP") and has in place an All-Employee Sharesave Plan ("Sharesave Plan"), both of which were approved by shareholders on 27 October 2010, shortly before Listing.

During the year, discretionary market-priced options and performance share awards were made under the LTIP to a focused participation group which included the Executive Directors, management team, high potential employees and key contributors – some 100 employees in total. A similar approach is planned going forward.

The Company has not operated the Sharesave Plan (and nor does it currently intend to do so) due to the high service cost and complexity of securities laws in those countries where the Group operates. In its place, in May 2012, the Company launched a ShareMatch Plan which will deliver one free matching share for every four shares purchased by an employee up to a certain maximum investment limit per employee per invitation (2012: £4,000). The take-up rate resulting from the initial invitation was 31% of eligible employees with an average investment of £2,074. The matching shares (totalling some 44,000) will vest on the first anniversary of the contract commencement, being 4 May 2013, and will be satisfied by the Company in the form of market purchased shares delivered from the EBT. It is intended that an annual invitation will be made under the ShareMatch Plan in all territories where the Company has an operating presence and local security laws and regulations permit such a Plan to operate.

Details of the LTIP, the ShareMatch Plan and their usage can be found in the Remuneration Report on pages 64 to 73. Details of grants and awards made under the LTIP and the ShareMatch Plan during the year, and outstanding in total at the year end, are given in Note 27 to the consolidated financial statements.

The following table outlines the impact arising from a change in control as prescribed in the rules of each share incentive plan:

| Share incentive plan | Change of control provisions contained within the share incentive plan rules | Effect on vesting | Performance condition |
|---|---|---|---|
| LTIP | Yes | Acceleration pro rata to service | Pro rata testing |
| ShareMatch Plan | Yes | Acceleration in full | Not applicable |

## Related party transactions
Details of related party transactions with Directors during the year are set out in Note 34 to the consolidated financial statements.

## Going concern
The Directors confirm they have a reasonable expectation that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future. This confirmation is made after having considered the Group's budget for the coming year together with outline projections beyond 2013 (both of which have been formally approved by the Board), and the potential risks and uncertainties to achieving these as described in Notes 3 and 26 the consolidated financial statements and the Principal Risks and Uncertainties on pages 35 and 37. In making their enquiries, the Directors have considered currency and country risk exposure and liquidity risk (including the availability and repayment profile of bank facilities, as described in Note 23 to the consolidated financial statements), as well as forecast covenant compliance. Accordingly, the Company has continued to adopt the going concern basis in preparing the consolidated financial statements and annual accounts for the year ended 31 December 2012.

## Additional disclosures
As a Luxembourg public company, certain disclosures are required to be made pursuant to Article 11 of the Luxembourg Law on Takeovers of 19 May 2006. The majority of such disclosures have already been made within the body of this Report. The following additional statements are also required to be made:

- The Ordinary shares are freely transferable, subject only to the restrictions set out in the Articles and as set out above in Lock-up Arrangements;
- As at the date of this report, the details of those shareholders with an interest of 5% or more in the issued share capital of the Company, as notified to the Company, are set out above under "Substantial shareholdings";
- All of the issued and outstanding Ordinary shares have equal voting rights and there are no special control rights attaching to them save that the control rights of the Ordinary shares held in the EBT can be directed by the Company to satisfy the vesting of outstanding awards to employees under its various employee share incentive plans;
- There are no agreements between the Company and its Directors or employees providing for compensation on loss of office or employment (whether through resignation, purported redundancy or otherwise) that would occur because of a takeover bid;
- The powers of Directors and, in particular the power to issue or buy back shares, are set out in the Articles. Shareholders' authority to empower the Directors to make market purchases of up to 10% of its own Ordinary shares is sought at the Annual General Meeting each year;
- The Company has entered into various agreements in the ordinary course of business around the world with major customers and suppliers. Some of these, either by their nature or value, may represent significant agreements and generally (as with the Company's standard terms and conditions of business) do provide a right of termination upon a change of control of the Company. The commercial sensitivity of these agreements prevent details being disclosed; and
- Save as disclosed above, there are no other significant agreements to which the Company is a party that take effect, alter or terminate upon a change of control following a takeover of the Company.

## 2013 Annual General Meeting ("2013 AGM")
The 2013 AGM will be held at 12 noon (CET) on Wednesday, 24 April 2013 at the Company's registered offices at 32-36 Boulevard d'Avranches, L-1160 Luxembourg. A separate circular, comprising a Letter from the Chairman, Notice of Meeting and Explanatory Notes, accompanies this Annual Report.

The Notice of the Meeting specifies deadlines for the exercise of voting rights and the appointing of a proxy or proxies to vote in relation to the resolutions to be proposed. All proxy votes will be counted and the numbers For, Against or Abstain (the latter of which is not a vote at law), in relation to each resolution, will be announced at the 2013 AGM and immediately announced publicly via a regulatory news service and published on the Company's website at www.azem.com.

## Auditors
A resolution to confirm the appointment of Deloitte Audit, Société à responsabilité limitée ("Deloitte"),as the Authorised Statutory Auditor (réviseur d'entreprises agréé) of the Company will be proposed at the 2013 AGM. The confirmation of Deloitte has been recommended to the Board by its Audit Committee and Deloitte have indicated their willingness to remain in office.

By Order of the Board

**Michael Arnaouti**
Company Secretary

18 February 2013

Governance

# Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report, including the consolidated financial statements, the Management Report (incorporated within the Directors' Report), the annual accounts and the Corporate Governance Report, in accordance with Luxembourg legal and regulatory requirements ("Company Law") and the applicable listing rules of the UK Listing Authority ("Listing Rules"). The Directors are also responsible for ensuring that the Annual Report is published in accordance with Company Law.

Company Law requires the Board of Directors to prepare consolidated financial statements for each financial year. The Directors are required by Regulation (EC)1606/2002 of 19 July 2002 ("IAS Regulation") to prepare the consolidated financial statements in accordance with International Financial Reporting Standards as adopted in the European Union ("IFRSs").

IFRS requires that the financial statements give a true and fair view of the Company's financial position, financial performance and cash flows for each financial year. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's "Framework for the preparation and presentation of financial statements". In doing so, the Directors are responsible for ensuring compliance with all applicable IFRSs so as to ensure that the financial statements give a true and fair view. The Directors are also required to properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance.

The Directors have elected to prepare the annual accounts of the parent company in accordance with the Luxembourg legal and regulatory requirements relating to the preparation of annual accounts. The annual accounts are required by law to give a true and fair view of the financial position of the Company as of the end of the financial year, and of its operations for the year then ended. In preparing these annual accounts, the Directors' responsibilities include: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the annual accounts that are free from material misstatement, whether due to fraud or error; making accounting estimates that are reasonable in the circumstances; and selecting appropriate accounting policies and then applying them consistently.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the annual accounts comply with the Company Law of 19 December 2002, as modified. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

## Responsibility Statement

We confirm that to the best of our knowledge and belief:

- the consolidated financial statements of AZ Electronic Materials S.A. ("Company") presented in this Annual Report and established in conformity with International Financial Reporting Standards as adopted in the European Union give a true and fair view of the assets, liabilities, financial position, cash flows and loss of the Company and the undertakings included within the consolidation taken as a whole;
- the annual accounts of the Company presented in this Annual Report and established in conformity with the Luxembourg legal and regulatory requirements relating to the preparation of annual accounts give a true and fair view of the assets, liabilities, financial position and loss of the Company; and
- the Management Report includes a fair review of the development and performance of the business and position of the Company and the undertakings included within the consolidation taken as a whole, together with a description of the principal risks and uncertainties it faces.

By Order of the Board

**Geoff Wild**
Chief Executive Officer

**Mike Powell**
Chief Financial Officer

18 February 2013

Governance
# Corporate Governance report

## Dear Shareholder,

Our report this year is structured so that our corporate governance arrangements and practices are reported against the five principles of the 2010 UK Corporate Governance Code ("Code"). In this section, we describe how these principles, and their supporting provisions, have become embedded in the way we organise the Board, its Committees and operational reporting lines through the Executive Directors, thus enabling the Board to discharge its responsibilities in a controlled and ongoing basis.

I am pleased to report that during 2012, the Company has moved to virtually full compliance with the Code, the only exception relating to my continuing Chairmanship of the Remuneration Committee. This position will be kept under review although it should be noted that major shareholders have expressed no concern with this arrangement. The only other area of Code non-compliance was addressed during 2012 with the completion of our inaugural performance evaluation of the Board, its Committees and of individual Directors.

Whilst continuing to report against the 2010 Code in respect of the year under review, the Board is mindful of the changes to the Code which will apply to reporting periods beginning on or after 1 October 2012 and which will therefore be relevant to AZ in respect of its 2013 financial year. In anticipation of the revised Code, the Board had already confirmed its support of the various initiatives to increase boardroom diversity which we view in a wider context than pure gender diversity. Pursuant to that, we were pleased to welcome Ms Philana Poon as an independent Non-Executive Director during the year; she brings fresh perspectives and insights and, being based in Asia, enhances our knowledge and understanding around the Board table of issues in an area where the Group has a major operating presence.

In addition, in order to reflect certain of the new Code changes being introduced, the Audit Committee's terms of reference have recently been amended to extend its reporting responsibilities and the Audit Committee Charter has also been extended to include a policy on audit tendering. By making these changes now, together with others yet to be made, we are aiming to ensure that the Board is ready to report compliance with the revised Code at the end of 2013.

**John Whybrow**
Chairman

18 February 2013

## Governance and Policy

This Report, together with the Remuneration Report on pages 64 to 73 and the Directors' Report on pages 48 to 51, describes how the Company has complied during the year with the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council in 2010 ("Code"). This Report also satisfies the requirements of Luxembourg Company Law.

The Company understands and supports the main principles set out in the Code and recognises the importance of high standards of good corporate governance. Throughout 2012, we complied with the provisions of the Code, except in relation to:

### Code Provision D.2.1
### Composition of the Remuneration Committee

The Company Chairman, John Whybrow, continues to chair the Remuneration Committee. Given Mr Whybrow's remuneration experience, both generally and specifically to AZ through his fulfilment of the same role held previously in other UK listed companies, the Board believes that he remains best suited to act as Remuneration Committee Chairman for the time being. The position will be kept under review although it should be noted that major shareholders have expressed no concern with this ongoing arrangement.

### Code Provisions A.4.2, B.6.1, B.6.2 and B.6.3
### Performance Evaluation

The inaugural performance evaluation of the Board, its Committees and of individual Directors was undertaken during the second half of the year in line with our committed timetable; the results are included in the body of this Report.

## Leadership

### The Board

The Board is responsible for the long term success of the Company and is accountable to shareholders for ensuring that the Group is appropriately managed and achieves its strategic objectives. It is also responsible for corporate governance, strategy, risk management and financial performance.

John Whybrow has led the Board as Chairman since the Company's listing on the London Stock Exchange in November 2010. The Board comprises two Executive Directors, being the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), and six Independent Non-Executive Directors, including the Chairman. Biographies of each of the Directors are given on pages 46 and 47. The current Board composition ensures that a proper balance of power exists and is maintained without any one person or group of persons having unfettered powers of decision making.

### The Chairman

The role of our Chairman is to lead and manage the business of the Board, providing direction and focus whilst ensuring that there is a clear structure for the effective operation of the Board and its Committees. He sets the agenda for discussions to promote effective, constructive and prioritised debate and to underpin a sound decision-making process, ensuring that the Board receives accurate, timely and clear information, in particular about the Company's performance. He facilitates the effective contribution of all Directors and is responsible for making sure Board members are aware of the views and objectives of major shareholders.

The Chairman works closely with the CEO to ensure that the strategies and actions agreed by the Board are effectively implemented and provides support and advice to the CEO, while respecting his executive responsibility for managing the Group. There is a clear division of responsibilities between these two distinct roles and these have been agreed by the Board and are set out in writing.

# Governance
# Corporate Governance report continued

## Non-Executive Directors

The Non-Executive Directors represent a strong, independent element of the Board and each brings with them his or her own expertise and skills gained in a variety of business sectors. They also bring strong judgement and objectivity to the Board's deliberations and decision-making process, helping to constructively challenge and support the executive. They provide effective leadership in relation to the Company's strategy, performance, risk and people management, as well as ensuring high standards of financial probity and corporate governance.

Ms Philana Poon was appointed to the Board as a Non-Executive Director on 29 June in place of Adrian Whitfield who stepped down on 25 May 2012.

The Board considers all its Non-Executive Directors to be independent in character and judgement and free from any business or other relationship which could materially interfere with the exercise of their judgement. At the date of publication, and throughout 2012, all of the Non-Executive Directors met the criteria for independence set out in the Code.

During the year, the Chairman met with the Non-Executive Directors on several occasions (both formal and informal) without the Executive Directors being present.

The Letters of Appointment of the Non-Executive Directors, and Service Agreements of each of the Executive Directors, are available for inspection at the Company's registered office during normal business hours.

## Senior Independent Director

Andrew Allner was appointed our Senior Independent Director ("SID") on 1 January 2012. His role is to act as a sounding board for the Chairman and to be a trusted intermediary for the other Directors. He is also available as an additional point of contact for shareholders if required.

## Chief Executive Officer ("CEO")

Our CEO, Geoff Wild, is responsible for the management of the business, developing the Group's strategic direction for consideration and approval by the Board and implementing the agreed strategy. The CEO, supported by Mike Powell as CFO, is assisted in this process by the Global Management Team ("GMT") which comprises the Executive Directors and members of senior management (see page 47 for membership details). The GMT is a decision-making forum which, during 2012, met monthly and operates under the direction and authority of the CEO. Its main role is to implement the Board's objectives and policies, address key operational issues and manage the day-to-day performance of the business. The activities of the GMT form part of the CEO's monthly report to the Board.

## Company Secretary

The Board has access to the advice and services of the Company Secretary, Michael Arnaouti, who has held this office since January 2011. He is a Fellow of the Institute of Chartered Secretaries and Administrators. The Company Secretary supports the Chairman in the delivery of the corporate governance framework, in particular in the planning of agendas for the annual cycle of Board and Committee meetings so that all key issues are considered at the appropriate times. He ensures that information is made available to Board members in a timely manner and advises the Directors on Board procedure and corporate governance matters. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

## Corporate Governance Framework

The Board discharges its responsibilities for the direction and control of the Group by:

- providing strategic leadership and support in a manner which maximises opportunities to develop the business profitability, whilst at the same time assessing and managing associated risks;
- engaging at Board meetings with, and challenging, the CEO, CFO and other members of the GMT, as appropriate, on the financial and operating performance of the Group and external issues material to the Group's prospects; and
- ensuring that the financial, management and other resources required to meet its objectives are in place.

A formal schedule of matters specifically reserved for the Board's decision has been adopted and is reviewed annually. These matters include:

| | |
|---|---|
| Strategy | • Group strategy and objectives<br>• Changes to Group structure and capital<br>• Material contracts, acquisitions and divestments |
| Governance | • Board and Committee membership<br>• Remuneration policy for senior executives<br>• Corporate governance matters<br>• Group policies<br>• Communications with shareholders |
| Risk management | • Internal controls and risk management systems<br>• Monitoring major risks and exposures |
| Financial performance | • Business plans and annual budgets<br>• Review of the Group's performance, as well as that of the management<br>• Financial reporting and controls, including approval of annual and interim reports and dividends |

In relation to non-reserved matters, these have been delegated to certain standing Committees of the Board and to the CEO as explained below:

## Board Meetings

The Board met six times during the year: four meetings were held in Luxembourg, one in Germany and a two-day strategic review in Japan. Each Director attended as follows:

| Members (Biographies appear on pages 46 and 47) | Number of meetings held in year whilst a Board member | Number of Board meetings attended |
|---|---|---|
| John Whybrow | 6 | 6/6 |
| Andrew Allner | 6 | 6/6 |
| Geoff Wild | 6 | 6/6 |
| Mike Powell | 6 | 6/6 |
| Gerry Ermentrout | 6 | 5/6 |
| David Price | 6 | 5/6 |
| Adrian Auer | 6 | 6/6 |
| Adrian Whitfield[1] | 2 | 2/2 |
| Philana Poon[2] | 4 | 4/4 |

Notes:
1. Resigned 25 May 2012.
2. Appointed 29 June 2012.

If a Director is unable to attend a Board or Committee meeting, he or she still receives all the papers and materials for discussion at that meeting. He or she will review them and then advise the Chairman or Committee Chairman of their views and comments on the matters to be discussed so that they can be conveyed to other members at the meeting.

Only members of the Board are entitled to attend Board meetings, with the Company Secretary in attendance to formally record each meeting. This is also the case in respect of Committee members and meetings. The Executive Directors and representatives of management, together with the Company's advisers, are also invited to attend Committee meetings as required. Directors have the right to raise any concerns they may have about the running of the Company, or a proposed course of action which cannot be resolved, and have them recorded in the relevant meeting minutes, and may also provide a written statement to the Chairman for circulation to the Board, setting out such concerns.

## Board Agenda

The Chairman and the Company Secretary are responsible for ensuring that the Directors receive accurate, timely and clear information on all relevant matters so that they are properly briefed in advance of meetings and the information is of sufficient quality to assist Directors in making informed contributions and decisions.

At each meeting, the Board receives regular updates from the CEO on the Group's operations (including R&D) and the CFO on financial performance, as well as capital expenditure requests, key project reviews, summary activities of the Board Committees and legal, compliance, and investor relations reports. Presentations and verbal updates are also given at Board meetings by the Executive Directors and, as appropriate, members of the GMT. During the year, the Board received presentations on a range of operational and R&D activities from local management and high potential employees who have been identified for career development.

In addition to the above, a 12-month rolling programme of items for discussion at Board meetings is in place so that all key issues are considered at the appropriate times. For 2012, such key issues, together with significant other matters requiring Board consideration, included:

- Preliminary Results Statement and Half-Year Report
- Annual Report and Accounts
- AGM and EGM Notices
- Corporate Risk Register and Strategic Risk Projects
- R&D Education and Training for NEDs
- Emerging Technologies Review
- ShareMatch Plan Adoption
- Trading Performance Updates
- Corporate Broker Change
- Strategic Plan 2013-17
- Group Debt Refinancing
- Board Performance Evaluation
- Group Insurance Renewal
- 2013 Operating Plan and Budget
- Succession Planning
- Group Reorganisation and Restructuring

During the year, a software application was introduced for the online delivery of Board and Committee papers. This is particularly important given the international nature of the Group and has facilitated the faster provision of information to Directors, increased flexibility of their time, greater security and ease of use whilst at the same time reducing the environmental and financial impacts of servicing Board and Committee meetings. All Directors now use tablet devices to access their papers and the meetings themselves are conducted in paperless form.

## Board Committees

To meet best corporate governance practice, the Board has delegated specific responsibilities to three standing Committees: the Audit, Remuneration and Nominations Committees. A summary of each Committee's membership, number of meetings held in 2012 and their respective terms of reference, is set out in the table below. The full terms of reference, which are subject to annual review, are available on the Company's website at www.azem.com. The Company Secretary acts as Secretary to all Committees.

Reports by each Committee, including their activity during the year and attendance at meetings, are given on pages 60 to 73.

# Governance
## Corporate Governance report continued

| Committee | Role and Terms of Reference | Membership | Number of meetings in 2012 | Report on pages |
|---|---|---|---|---|
| Audit | Reviews the financial and internal reporting process, the integrity of the financial statements, the system of internal controls, the identification and management of risks and the external and internal audit processes. The Committee also proposes to shareholders the appointment of the external auditors and is directly responsible for the remuneration and oversight of their work. | Andrew Allner*<br>David Price<br>Adrian Auer | 4 | 60-62 |
| Remuneration | Makes recommendations to the Board on the Company's framework and broad policy for the remuneration of the Chairman, Executive Directors and other members of the senior management team. The remuneration of the Non-Executive Directors is a matter for the Board. | John Whybrow*<br>Andrew Allner<br>Gerry Ermentrout<br>Adrian Auer<br>Philana Poon | 6 | 64-73 |
| Nominations | Reviews the structure, size and composition of the Board and appointment of members to the Board. The Committee also monitors the planning of succession to the Board. | John Whybrow*<br>Andrew Allner<br>Gerry Ermentrout<br>David Price<br>Adrian Auer<br>Philana Poon | 3 | 63 |

*Chairman

A Disclosure Committee of the Board is also established with its membership comprising the Chairman, CEO and CFO. This Committee meets as required to deal with the control of price sensitive information within the Group and to ensure that timely announcements are made in accordance with the Company's obligations under the Listing Rules and the Disclosure and Transparency Rules. Its terms of reference are also available on the Company's website.

### Effectiveness

#### Board composition
We seek to build an effective and complementary Board which comprises the correct balance of individuals, and whose capabilities are appropriate for the scale, complexity and strategic positioning of our business. The process for Board appointments is led by the Nominations Committee and is described on page 63.

The Non-Executive Directors are drawn from a range of industries and backgrounds, including the electronic and specialty chemicals industries, semiconductor manufacturing, defence and aerospace, building materials and construction, transport services and telecommunications. They are all considered to have appropriate experience of complex organisations with global reach.

#### Board diversity
The Board's approach to Director appointments is always to ensure that the right individual with the most appropriate skills and experience is recruited to complement and supplement the existing Board balance and effectiveness. The terms of reference of the Nominations Committee provide that diversity, in the broadest sense of the word, is taken into account when reviewing the composition of the Board and looking for new Directors. During the year, Ms Philana Poon joined the Board as an Independent Non-Executive Director. As a new appointee, she brings fresh perspectives and insights and, being based in Asia, enhances our knowledge and understanding around the Board table of issues in an area where the Group has a major operating presence.

#### Time allocation
It is in the whole Board's interest to ensure that all Directors have sufficient time to commit to their responsibilities as Directors. The Chairman monitors the extent of Directors' other interests to ensure that the effectiveness of the individual and the Board is not being compromised.

In respect of the appointment of new Non-Executive Directors to the Board, candidates are made aware of the time commitment expected of them (and are required to demonstrate their ability to deliver on the same) which is reflected in their individual letters of appointment with the Company. The Board considers that all the Directors are currently able to devote sufficient time and attention to their AZ duties and responsibilities.

As part of their continuing development, and recognising the significant benefits to be derived to both the Company and the individual, Executive Directors are permitted to accept one external non-executive directorship with a non-competing company provided that they first obtain permission from the Chairman. During the year, Geoff Wild held such an external directorship with Materion Corporation, a USA listed supplier of highly engineered advanced enabling materials.

#### Board induction and training
The Company Secretary assists the Chairman in designing and facilitating a tailored induction and ongoing training programme for new Directors. Upon appointment, a Director is given access to recent Board meeting materials and to an electronic reference library of relevant documents and legal and other matters of which they need to be aware. This is reinforced by face-to-face meetings between the newly appointed Director and both the Chairman and the Company Secretary which focuses on Board operations and guidance on the duties and obligations as a Director of AZ. The induction programme for Non-Executive Directors also includes meetings with, and presentations by, members of the GMT and management to explain the Group's business. It also extends to meetings with the Company's auditors, lawyers and brokers to

cover the legal and compliance framework within which the Company operates, as well as covering market and investor perspectives. This approach was followed in respect of Philana Poon who joined the Board as a Non-Executive Director in June.

During the year, the Board held two of its meetings at operating locations in Japan and Germany with a view to helping Directors gain a deeper understanding of the business and its cultural environment, and to give them a chance to meet local management and employees.

The Board is kept up-to-date on legal, regulatory and governance matters through regular reports from the Company Secretary. It also receives presentations by internal and external advisers and updates on relevant industry and market news and economic issues.

The Chairman meets with each Director annually on a one-to-one basis to discuss his or her individual performance and contribution and to agree any ongoing personal training and development needs.

### Performance evaluation

In line with our committed timetable, we completed our first formal performance evaluation since flotation in 2010. Informal reviews and monitoring had taken place previously by the Chairman and formal reviews will now take place on an annual basis as recommended by the Code.

This year's evaluation process was internally facilitated and took the form of a comprehensive online survey completed by all Directors covering the Board, its Committees, the Chairman and individual Board members, the latter in respect of both self-assessments for all Directors and the cross-assessment of the Non-Executive Directors – there is a separate process for the performance evaluation of the Executive Directors. The overall process was led by the Chairman and supported by the Company Secretary. Its purpose was to provide insight into our overall effectiveness and assurance that key relationships are working well, to identify any gaps in knowledge and skills, to provide an action plan for improving performance and to establish a benchmark against which to measure future progress.

The subject areas covered a variety of aspects associated with effectiveness and performance, with views being sought on matters such as:

- the current culture and composition of the Board, its operation and how changes made since Listing had settled down;
- input into strategy discussions, the relevance and objectivity of information and how it flows, the quality of shareholder engagement and relationships, the adequacy of governance, compliance and risk management reviews, and the management of succession planning;
- specific areas of Committee responsibility;
- structure, process, efficiency, and exploring ways to improve operations generally; and
- levels of contribution from and relationships with senior management.

The feedback results were analysed by the Company Secretary and then reviewed and evaluated in consultation with the Chairman (except in relation to the performance of the Audit Committee and the Chairman himself, as this feedback was reviewed and consulted on with Andrew Allner in his capacity as Chairman of the Audit Committee and Senior Independent Director respectively).

A summary of the feedback relating to the Board, its Committees and the Chairman was circulated to each Board member with the results presented to, and discussed by, the Board at its December meeting.

The evaluation concluded that the Board is in good shape and there exists a high level of respect between the Directors who work well together and with the executive management team. The quality of debate was high and there was strong leadership of the Board and its Committees. The level of information and presentations provided to Directors was of good quality and there was an acknowledgement that a set of well-functioning processes were in place and effective. Only some minor areas of improvement were identified, mainly centered around:

- how we can maximise the effectiveness of the Board's time during periods where the Directors come together; and
- the need to drive the agenda on succession planning in order to ensure the proactive development of key managers and identified high potential employees.

The Chairman followed up on the results of the individual self-assessments and cross-assessments through one-to-one interviews held with each Director.

The Non-Executive Directors also met in the year to review the performance of the CEO and CFO. In addition, led by the Senior Independent Director, they met separately without the Chairman being present to review the Chairman's performance which they confirmed was of a high standard.

### Re-election of directors

At our AGM in May 2012, all Directors retired from office and offered themselves for election or re-election. Each Director was confirmed to office with no-one receiving less than a 96% vote of support from shareholders. At the forthcoming AGM in April 2013, all of the Directors, including Philana Poon who was appointed to office during the year, will again retire and offer themselves for election or re-election as the case may be.

All of the Directors participated in the formal performance evaluation process in 2012 (as set out above) and it is believed that they each continue to be effective and demonstrate commitment to their respective roles. Accordingly, the Board recommends that shareholders again vote to support and approve the resolutions to be proposed at the 2013 AGM relating to the election and re-election of Directors.

### Directors' Conflict of Interests

Under the Company's Articles of Association (which are those of a Luxembourg registered company), any Director having an interest in a transaction conflicting with that of the Company must advise the Board in advance with a record made in the minutes of the relevant meeting. The notifying Director is then prohibited from taking part in the deliberations concerning that particular transaction. It is also a requirement that at the next following shareholders' meeting, a report must be presented on any transaction in which a Director has declared an interest conflicting with that of the Company.

### Independent advice

The Board recognises that there may be occasions when one or more of its Directors or Committees feel it is necessary to take independent legal or other professional advice at the Company's expense in furtherance of their duties. There is an agreed process in place to enable them to do so. Directors may also secure the attendance of external advisers at their meetings and seek information from any employee of the Group.

Governance
# Corporate Governance report continued

## Accountability

The Board recognises its responsibility to present a balanced and understandable assessment of the Group's position and prospects.

The Statement of Directors' Responsibilities for preparing the accounts may be found on page 52 and the auditors' statement about their reporting responsibilities on pages 74 and 115. The Audit Committee has been established with wide-ranging oversight responsibilities covering the Group's financial, internal control and governance arrangements, including reporting, auditing and risk management, and these are reviewed and reported to the Board on a regular basis. The Audit Committee is also responsible for maintaining and managing an appropriate relationship with the Company's external auditor. Further details of the Audit Committee, its membership, and the various activities carried out during the year can be found in the Audit Committee Report on pages 60 to 62.

### Internal control framework and risk management

The Board is ultimately responsible for the good standing of the Company, the management of assets for optimum performance and for the operation of an effective system of internal control appropriate to the business. The Group maintains a robust system of internal control which is designed to identify, evaluate and manage, rather than eliminate, the risks faced by the Group in seeking to achieve its business objectives. Such a system can therefore only provide reasonable and not absolute assurance against material misstatement or loss.

### Internal control environment

The following key elements comprise the Group's current internal control environment:

- an organisation structure with clear operating procedures, lines of responsibility and delegated levels of authority and approval limits;
- a flat management structure which facilitates both open and timely communication;
- a comprehensive strategic and annual planning process;
- a robust budgeting and forecasting process which this year was extended to cover a projected two-year outlook beyond the 2013 budget year. This process includes regular performance reporting and review at both GMT and Board level (see below);
- a six-monthly system of compliance certification from managers concerning the operation of the business for which they are responsible;
- various legal and ethical standards policies, including an anti-bribery and corruption policy and whistle-blowing policy; and
- an ongoing risk management process, including a comprehensive business continuity plan.

### Performance reporting and information

Day-to-day operating and financial responsibility rests with the executive and senior management and performance is closely monitored through the GMT which meets on a monthly basis and is chaired by the Chief Executive Officer.

The Group has in place a comprehensive financial review cycle, which includes a detailed annual budgeting process where business units prepare budgets which are reviewed by the executive and approved by the Board.

At a Group level, a well-developed management accounts pack, including profit and loss account, balance sheet and cash flow statements, key performance indicators and risk and opportunity assessments, is issued and reviewed monthly by the GMT and bi-monthly by the Board.

As part of the monthly reporting process, performance is monitored against the approved budget and a reforecast of the current year is also undertaken. To ensure consistency of reporting, the Group has a global Enterprise Resource Planning system and a global consolidation system in place, as well as common accounting policies and procedures.

The Group uses a number of performance indicators to measure both operational and financial activity in the business and details of the key performance indicators are included on pages 10 and 11. Depending on the measure, these are reported and reviewed on a weekly, monthly or quarterly basis. In addition, management in the business receive a monthly pack of indicators on their performance which is reviewed at business unit meetings with corrective action being taken as necessary.

Management monitors the publication of new financial reporting standards and works closely with the external auditor in evaluating in advance the potential impact of these standards on the Group.

### Risk management

The Board has in place a Risk Management Policy with the objective of ensuring that shareholders' interests are protected and that the Company's resources are properly safeguarded. It sets out the requirements, processes and procedures necessary for financial, operational and compliance control and risk management to form an integrated part of the Group's internal control and decision-making environment.

On a practical level, there exists within the Group an embedded culture of ownership and responsibility for business risk management at operating level which has been established over many years. The risk management framework operates to provide a system for identifying the nature and extent of risks faced by the Group, evaluating such risks and the likelihood of them occurring and then ensuring that material risks are monitored, managed and, wherever possible, mitigated in a timely manner. Where risk cannot be adequately mitigated, a global programme of insurance exists. Risks are regularly reviewed at business unit, divisional and GMT level, recorded in a central risk register and reviewed by the Audit Committee at least twice a year and by the Board annually.

The risk management framework was further enhanced during the year with completion of a Group-wide risk assessment review which started in 2011. It was led by the Chief Executive and supported by the Head of Risk and Strategic Projects (who has a direct reporting line to the Chairman of the Audit Committee). The outcome of this important exercise provided:

- a more measured insight and understanding of our key risk exposures, both from a bottom-up and top-down perspective;
- specific action plans to manage and mitigate our key risks, and an advanced line of sight so that resources and responsibilities are prioritised and allocated accordingly;
- increased visibility to management, the Audit Committee and the Board of those significant financial, operational and reputational risks capable of impacting our ability to achieve AZ's operating performance targets and longer-term strategic objectives; and
- a comprehensive corporate risk register accompanied by a robust risk assurance control map.

The Group has commenced a focused risk review of each of the major risks identified in the above exercise. Further details of these and the progress made during the year, together with how we find ourselves in the final year of a three-year risk review cycle, and what that means for us in 2013, is set out in the Risk and Uncertainties section on pages 35 to 37.

### Review of effectiveness

The work conducted by management is complemented, supported and challenged by the controls assurance work carried out independently by our internal audit partners, Ernst & Young. Regular reports on control issues are presented to the Audit Committee. Further details are set out in the Audit Committee Report on pages 60 to 62.

Assisted by the Audit Committee, the Board has reviewed the effectiveness of the Group's system of internal control in place throughout the year and up to the date of this Report.

As we seek to continually improve our control framework, we identify control matters which need to be addressed. Where these have been identified, new procedures have been introduced to strengthen controls in the relevant areas. These improved controls will themselves be subject to regular review as part of our assurance process.

The Board can confirm that it has not identified, nor has it been advised of, any weakness or control failure that is significant to the Group.

The Board considers on a regular basis the position of the Company as a going concern by reviewing Group budgets, cash flow forecasts, liquidity, bank facilities and terms, and currency and country risk exposures. A statement by the Board confirming the Company's position as a going concern forms part of the Directors' Report on pages 48 to 51.

## Relations with shareholders

The Board is committed to maintaining an open dialogue with shareholders and recognises the importance of that relationship in the governance process. The Chairman, supported by the Executive Directors, has overall responsibility for ensuring effective communication with shareholders.

A focused and proactive investor relations programme is in place. This is led by the CEO and CFO and supported by the Head of Investor Relations. It is aimed at having regular dialogue with institutional investors in order to develop a greater understanding of their objectives and views. Comprehensive feedback reports are then shared with all Directors and discussed at each Board meeting.

The Company held its first Capital Markets Day in London in September which was well attended by representatives of the investor community. This provided a focused opportunity for institutional investors to meet members of AZ's senior management team, to learn more about the key operational areas of the business and to have a greater insight into our long term growth drivers. During the latter part of the year, the Chairman undertook an investor visit programme and met with the corporate governance and chief investment officers of several of our major shareholders with discussion covering corporate governance matters, general trading conditions, AZ's strategic focus and executive remuneration.

Regular communication with all shareholders is made through publication of the Company's full-year and half-year results and interim management statements, all of which provide information on the Group's performance and prospects. The CEO and CFO present these live to institutional investors, analysts and the media with the presentations also being made available to shareholders generally at the same time via audiocast on the Company's website.

A Disclosure Policy and a Disclosure Committee have been established to ensure that price sensitive information is identified and notified to the markets and shareholders in a timely and accurate manner. The Company Secretary generally deals with questions from individual shareholders.

The Company's website at www.azem.com provides an important tool for investors to learn about the Group's activities, its products and latest news.

All shareholders have the opportunity to ask questions at the Company's AGM or at any other times by emailing or writing to the Company. The Chairmen of the Audit, Nominations and Remuneration Committees will be available to answer questions relating to the responsibilities of those Committees at this year's AGM.

## Annual General Meeting

The Company's 2013 AGM will be held on Wednesday, 24 April at our registered office: 32-36 Boulevard d'Avranches, L-1160 Luxembourg. The Notice convening the AGM (or "Meeting") which accompanies this Annual Report has been issued at least 20 days before the Meeting. It sets out the business to be considered at the Meeting and includes separate resolutions on each substantially separate issue. Voting on all the resolutions being proposed will be on a poll and the results of the votes cast per resolution will be published on the Company's website and publicly announced via a Regulatory News Service immediately following the Meeting.

## Changes to the UK Corporate Governance Code

### 2012 Code

The Board is mindful of the changes to the UK Corporate Governance Code which came into force on 1 October 2012 ("2012 Code") and which will apply to reporting periods beginning on or after that date. Whilst the Company is not required to report against the 2012 Code until the financial year ending 31 December 2013, we anticipated certain of the changes which will impact Audit Committees (as set out in the Financial Reporting Council's 'Guidance on Audit Committees') and amended the Audit Committee's terms of reference in order to extend its reporting responsibilities. The Audit Committee Charter has also been revised to include a policy on audit tendering. Further details on these changes are set out in the Audit Committee Report on pages 60 to 62. By making these changes now, together with certain others yet to be made, we are aiming to ensure that the Board is ready to report compliance with the 2012 Code at the end of 2013.

### Diversity

The terms of reference of the Nominations Committee provide that diversity, in the broadest sense of the word, is taken into account when reviewing the composition of the Board. The Board also recognises the requirement introduced by the 2012 Code to describe within the Nominations Committee Report the Board's policy on diversity (including gender) any measurable objectives that it has set for implementing the policy and progress on achieving the objectives. Compliance against this particular topic will be disclosed in next year's Annual Report.

Governance

# Audit Committee report

The Audit Committee's work continues to evolve and adapt as the Group builds on its foundations and moves into the next stages of its development. The Committee's primary objectives for 2012 have been to ensure the continued integrity and substance of the Group's financial control function and to oversee the effectiveness of the Group's system of internal controls and risk management.

During the year, the Committee's agenda included the usual review of our financial results and controls and also extended to provide focused attention on other key areas such as:

- monitoring the implementation progress of the Group's Anti-Bribery and Corruption programme;
- overseeing the contribution and effectiveness of the outsourced internal audit function through the consideration of a series of comprehensive internal audit reports undertaken across the business; and
- reviewing the key risks and uncertainties identified within the business and monitoring the delivery of the risk management projects undertaken to address them.

The Committee will continue to build on its solid progress and intends, over the course of 2013, to develop and enhance reporting around the new UK Corporate Governance Code requirements and to ensure continued improvement in the value and efficiency of the external audit process.

**Andrew Allner**
Chairman, Audit Committee

## Membership

The membership of the Audit Committee ("Committee"), together with appointment dates and attendance at meetings during the year, is set out below:

| Members (Biographies appear on pages 46 and 47) | Committee member since | Attendance at meetings in 2012 |
|---|---|---|
| Andrew Allner (Chairman) | 12 October 2010 | 4/4 |
| David Price | 4 May 2011 | 3/4 |
| Adrian Auer | 4 May 2011 | 4/4 |

Other attendees at Committee meetings:

| Attendee | Regular attendee | Attends at Chairman's invitation |
|---|---|---|
| Company Secretary | ✓ | |
| Company Chairman | ✓ | |
| Chief Executive Officer | ✓ | |
| Chief Financial Officer | ✓ | |
| Head of Group Finance | ✓ | |
| Group Treasurer | | ✓ |
| Head of Risk and Strategic Projects | | ✓ |
| External Auditor: Deloitte Audit, Sàrl | ✓ | |
| Internal Audit service provider: Ernst & Young LLP | | ✓ |

## Responsibilities

The responsibilities of the Committee are set out in its terms of reference which are available on the Company's website at www.azem.com, and these are primarily:

- to review the integrity of the full-year and half-year results and financial statements, including the Group's accounting policies and procedures and its financial control environment;
- to monitor and review the effectiveness of the Group's system of internal controls and risk management;
- to oversee the activities of the internal audit function;
- to review significant tax related matters associated with the Group's business and corporate structure;
- to consider the appointment, independence, service provision and remuneration of the external auditor, and the overall relationship with them; and
- to review the Group's standards of business conduct, ethics and values and arrangements by which staff may raise concerns about possible improprieties in a safe and confidential manner.

The Committee reviews its own performance, constitution and terms of reference on an annual basis to ensure that it is operating at maximum effectiveness.

The Committee recognises the changes which will impact Audit Committees arising from the new UK Corporate Governance Code published by the Financial Reporting Council in September 2012 ("2012 Code") and which will apply to our 2013 financial year. The Committee's terms of reference have been amended to extend its reporting responsibilities relating to:

- the significant issues that the Committee considers in relation to the financial statements and how these are addressed;
- the Committee's assessment of the effectiveness of the external audit process and its recommendation on the appointment or reappointment of the external auditor; and
- the provision of advice to the Board on whether the annual report and accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

Whilst the Company is reporting against the 2010 UK Corporate Governance Code for the financial year under review, we are aiming to ensure that the Committee is ready to report compliance with the 2012 Code next year.

## Qualifications of the Audit Committee Members

Committee members bring significant, recent and relevant financial and accounting experience to the Committee's work. Members have past employment experience in either finance or accounting roles, or comparable experience in corporate activities.

| | Financial and Accounting Experience |
|---|---|
| Andrew Allner (Chairman) | • Fellow of the Institute of Chartered Accountants in England and Wales<br>• Former Partner of Price Waterhouse<br>• Group Finance Director of RHM plc (2004 – 2007)<br>• Senior Independent Director and Chairman of the Audit Committee of The Go-Ahead Group plc<br>• Chairman of the Audit Committee of CSR plc and Northgate plc |
| Adrian Auer | • Non-Executive Chairman of Shanks Group plc<br>• Former Finance Director in a number of major companies<br>• Senior finance positions held previously with BP and ICI |
| Dr David Price | • CEO of Chemring PLC (2005 – 2012)<br>• Former Managing Director of the naval marine business of Rolls-Royce plc and the UK business of Thomson-CSF<br>• Former Chief Executive of Thomson-Thorn Electronics |

## Activities

In 2012, the Committee worked to a structured programme of activities comprising standing items that the Committee is required to consider at each meeting and other matters timed to coincide with key events in the Company's annual financial reporting cycle. During the year, and through to the date of this Report, the matters reviewed, amended and/or recommended to the Board for approval (as appropriate) by the Committee related to:

- the 2011 and 2012 full-year financial statements, and the corresponding preliminary announcement of results and annual report and accounts;
- a technical review of the Company's ability to pay the 2011 final and 2012 interim dividends;
- the 2012 half-year financial statements, and the corresponding half-year announcement of results and report to shareholders;
- the adequacy of the internal controls and governance relating to the Group's continued refinement of its operating structure;
- the monitoring of the outsourced (though internally directed) internal audit function, and the consideration of internal audit reports received and corrective actions required;
- the performance, effectiveness and continued independence of the external auditor;
- material accounting and auditing matters;
- corporate governance and legal and regulatory compliance, including the continued implementation of the Company's Anti-Bribery and Corruption programme to comply with the UK Bribery Act 2010;
- consideration of a proposal to commence the Group's debt refinancing programme, which was successfully completed in early December 2012;
- key policies and procedures, including treasury, tax and risk management; and
- the appropriateness and effectiveness of the Company's internal control system and risk management process, including consideration of various key financial risks and uncertainties undertaken as part of the Group's major risk review programme.

## Internal audit

Ernst & Young have acted as the retained service provider of the Company's internal audit function since their appointment in 2011 for an initial two-year period. They work under the direction of the Head of Risk and Strategic Projects but report directly to the Audit Committee which agrees their plan of work annually in advance. This approach makes effective and added value use of Ernst & Young's specialist expertise and knowledge through their team of experienced professionals across a number of countries in which the Group operate.

The purpose of the internal audit function is to provide an independent, objective assessment of the Group's system of internal control and underlying business processes which:

- provides assurance on the effectiveness of AZ's internal control system;
- addresses the safeguarding of assets, compliance with applicable laws and regulations and achievement of management's operational objectives; and
- promotes business processes that deliver effective internal control at reasonable cost.

Governance
# Audit Committee report continued

An Internal Audit Charter sets out the responsibilities of both the internal audit function (in terms of its programme of activity, scope of investigations and reporting lines to the Committee) and management (in terms of their providing support and cooperation at all levels of the business).

During 2012, a targeted internal audit plan was agreed and carried out on certain of the Group's operations, systems and support functions with subsequent reports, including management responses and recommended action plans, considered by the Audit Committee in February, August and December. These reports related to audits carried out on our operations in the USA, UK, Germany, South Korea and Japan (where the main focus was on financial controls and identified country-specific risks) and on our IT Information Security system and controls. The Committee also reviewed follow-up reports on audits undertaken in 2011 on the Group's Treasury function and on our Taiwanese operations. A focused internal audit plan is in place for 2013.

At least twice a year, the Committee meets with representatives of Ernst & Young without management being in attendance.

## Anti-Bribery and Corruption

The Company fosters a strong culture of good governance, including maintaining high ethical standards and strong personal integrity. In relation to bribery and corruption, this is reflected in the Board's declared zero tolerance policy and in the Group's formal Anti-Bribery and Corruption Policy which make it clear that AZ will not tolerate any form of corruption or bribery by any employee or third-party representative.

During 2012, and as part of our commitment to enhancing awareness and protections in this important area, we:

- launched an e-learning training and self-assessment programme which has been undertaken by all employees Group-wide – it now forms part of our new employee induction programme;
- undertook, in conjunction with Ernst & Young, a bribery and corruption risk review workshop at each of our country operations with management, human resources and key functional members of staff in attendance. The aim was to help us better understand, identify and manage the potential risk exposures in this area. All local action plans have been, or are in the process of being, completed.

A guidance programme in connection with the local appointment of third-party representatives, and related parties generally – be they customers, suppliers and others – has been established and will be rolled-out in the first quarter of 2013.

## External Auditor

Deloitte Audit, Société à responsabilité limitée, has been the Company's external auditor since Listing. One of the key tasks of the Committee is to review the independence of the external auditors and monitor their continued effectiveness. The Committee and the Board place strong emphasis on the objectivity of the external auditor and to this end an Audit Committee Charter exists (and is reviewed annually) which sets out the Company's policy on:

- the independence and objectivity of the external auditor;
- the use of the external auditor for non-audit services, including specifically excluded services, financial limits and pre-approval requirements; and
- the employment of former employees of the external auditor.

The Audit Committee Charter was updated in December 2012 to include an approved policy on the frequency of audit tendering in response to the changes arising from the 2012 Code. Pursuant to this, the Committee will, at a minimum, put the audit services contract out to tender at least once every ten years, unless there are significant events taking place at such time which would make it inappropriate to do so.

In addition, the Audit Committee monitors the fees received by the external auditor for non-audit work. An analysis of non-audit fees paid in 2012 can be found in Note 6 to the consolidated financial statements.

To ensure effective communication of matters relating to the audit, the audit partner, Chief Financial Officer and, as required, senior members of the finance function, are present at Audit Committee meetings.

At least twice a year, the Committee meets with representatives of Deloitte without management being in attendance.

The rotation of the audit partner's responsibilities within the external auditor is required every five years by the profession's own ethical standards. During the course of 2013, it is intended that the Committee will interview candidates put forward by Deloitte with a view to appointing a new audit partner.

An overall performance evaluation of the auditor will continue to be undertaken annually by the Committee, taking into account the views of management and feedback provided to senior members of the auditor who are unrelated to the Company's audit. This activity also forms part of the auditor's own internal quality control system. The Committee considers the evaluation results in conjunction with any recommendation to the Board on the reappointment of the Company's auditor.

The policies and procedures described above provide the Committee with confidence that the independence of the external auditor, and their audit function, will be maintained.

The Committee has completed its assessment of the external auditor for the financial period under review. Having satisfied itself as to their qualification, expertise, resources and independence, and the effectiveness of the audit process, the Committee has recommended to the Board the reappointment of Deloitte Audit, Société à responsabilité limitée, as the Company's external auditor and the approval, during the course of the year, of their fees and terms of engagement for 2013. These matters are subject to shareholders approval at the 2013 AGM.

## Committee evaluation

As part of the inaugural Board performance evaluation process, the Committee undertook its own performance evaluation. This confirmed that the Committee was both effective and efficient in its operation and leadership, with no material areas identified for improvement or attention. Details of the process and its outcome are provided within the main Corporate Governance Report on pages 53 to 59.

## Conclusion

The Committee fully appreciates the importance of its role. It will continue to review and develop its practices with particular ongoing focus on internal controls and risk management together with scrutiny of the financial statements and their preparation.

Governance
# Nominations Committee report

The main focus of the Nominations Committee this year has been the search to identify and recruit a Non-Executive Director based in Asia where the Group has a major operating presence. I am pleased to report that following a thorough search and interview process conducted from Hong Kong, Ms Philana Poon was recommended by the Committee and approved by the Board. As a new appointee, she brings to the Board fresh perspective, new insights and valuable transaction experience in this key geographical area for the Group.

**John Whybrow**
Chairman, Nominations Committee

## Membership
The membership of the Nominations Committee ("Committee"), together with appointment dates and attendance at meetings during the year, is set out below:

| Members (Biographies appear on pages 46 and 47) | Committee member since | Attendance at meetings in 2012 |
|---|---|---|
| John Whybrow (Chairman) | 12 October 2010 | 3/3 |
| Andrew Allner | 12 October 2010 | 3/3 |
| Gerry Ermentrout | 12 October 2010 | 3/3 |
| David Price | 4 May 2011 | 2/3 |
| Adrian Auer | 4 May 2011 | 3/3 |
| Adrian Whitfield[1] | 4 May 2011 | 2/2 |
| Philana Poon[2] | 29 June 2012 | 1/1 |

Notes:
1. Resigned 25 May 2012.
2. Appointed 29 June 2012.

Other attendees at Committee meetings:

| Attendee | Regular attendee | Attends at Chairman's invitation |
|---|---|---|
| Company Secretary | ✓ | |
| Chief Executive Officer | | ✓ |
| External advisers: as appropriate | | ✓ |

## Responsibilities
The Nominations Committee is responsible for ensuring that the Board has in place the correct balance of individuals to discharge its duties effectively and for leading the process by which new Board members are appointed. It also advises the Board on succession planning for Directors.

The responsibilities of the Nominations Committee are set out in its terms of reference which are available on the Company's website at www.azem.com, and these are primarily:

- to review the structure, size and composition of the Board and its Committees and make recommendations to the Board with regard to any changes considered necessary, both in the identification and nomination of new Directors and the continuation in office of existing Directors;
- as part of the formal procedure in place for selecting and recruiting Directors, to evaluate the balance of skills, knowledge and experience on the Board and prepare a description of the role and capabilities required of prospective candidates;
- with a view to identifying suitable candidates, to consider both the use of open advertising or retention of external consultants to facilitate the search; and
- after a rigorous interview process of shortlisted candidates, to make recommendations to the Board.

## Activities
During 2012, the Committee's main focus was the search for an additional Non-Executive Director based in Asia with a view to enhancing our knowledge and understanding around the Board table of issues in an area where the Group has a major operating presence. The Committee engaged the services of a specialised search consultancy, Russell Reynolds in Hong Kong, to assist with the regional search. Following a thorough interview process conducted locally by myself, Andrew Allner and Geoff Wild, two short-listed Asian-based candidates were identified. Post review and onward recommendation by the Committee, Ms Philana Poon was confirmed by the Board as the successful candidate and joined the Board on 29 June 2012.

## Committee evaluation
As part of the inaugural Board performance evaluation process, the Committee undertook its own performance evaluation. This confirmed that the Committee was both effective and efficient in its operation and leadership, with no material areas identified for improvement or attention. Details of the process and its outcome are provided within the main Corporate Governance Report on pages 53 to 59.

## Conclusion
The Nominations Committee is not presently considering any Board changes as we believe that its current composition, in terms of size, skills, knowledge and experience, is appropriate to the Company's needs.

Governance
# Remuneration report

### Dear Shareholder,

The Remuneration Committee remains committed to ensuring that AZ's remuneration policies are aligned to the successful recruitment, retention and motivation of its Executive Directors and directed towards rewarding superior performance. These principles are also applied to the senior management team.

During the year, the Committee considered further revisions to the existing executive remuneration structure with the aim of strengthening its alignment with both our strategic objectives and good governance practice.

The changes of particular note effected during the year, which are explained in the body of this Report, included:

- the bringing of the CEO's remuneration more into line with that of an international UK listed company;
- establishing a more focused annual bonus plan for 2013 (without changing the quantum); and
- a variation to the Executive Directors' service contracts.

Of these items, the key change was the alignment of the CEO's salary to competitive market practice. In our 2011 Report, we explained that pursuant to our remuneration policy we intended to adopt a phased salary increase approach for Geoff Wild, with a view to moving him to a mid-market competitive position over a 2-3 year period, subject to his performance and that of the Company. Following the Company's successful IPO in November 2010, a first phase increase of 15% was awarded in 2011. However, given the tough economic environment which was forecast (and materialised) in 2012, the planned second phase increase for last year was postponed, with only a limited 2% increase being awarded instead in line with the average pay award to the wider Group workforce. For 2013, the Committee has decided to reinstate and progress the phased increase plan such that Geoff's salary for the current year will increase by 20% to US$703,800 effective from 1 January 2013. Whilst the Committee recognises that this is a significant one-off increase, we feel it is both appropriate and necessary at this time to align the package of the CEO with competitive market rates. The increase takes into account both the Company's performance since it floated and Geoff's strong performance in leading the business during that time. The Committee's decision was taken after consulting with the Company's major shareholders, as well as both the ABI and RREV. Even with this increase, Geoff's salary remains slightly below the market median based on current benchmark data. This is described in more detail in the Report together with guidance on how we intend to satisfy the residual shortfall going forward.

The Committee is aware of the expected changes to the corporate governance landscape as a result of proposals put forward by the UK Department for Business Innovation & Skills ("BIS") in respect of new regulatory reporting requirements. During 2013, once the BIS regulations have been finalised, the Committee will consider the impact of these changes both on its executive remuneration policy and on its reporting obligations. In the meantime, this year's Report is presented against the current reporting requirements.

The Committee remains keen to maintain an open dialogue with shareholders on the subject of executive remuneration and would appreciate any comments or feedback you may have. We look forward to your support of the resolution to approve this Report at the Company's forthcoming Annual General Meeting.

**John Whybrow**
Chairman, Remuneration Committee

### Introduction

This Report has been prepared on behalf of the Board by the Remuneration Committee ("Committee") having regard to the Financial Services Authority's Listing Rules, the Companies Act 2006 and Schedule 8 to the Large and Medium Sized Companies (Accounts and Reports) Regulations 2008. The Report also sets out how the relevant principles of the UK Corporate Governance Code ("Code"), published by the Financial Reporting Council in 2010, have been applied. It has been divided into Section A and B containing unaudited and audited information respectively.

## SECTION A: UNAUDITED INFORMATION

### Committee composition, responsibility and activities

The membership of the Committee, together with appointment dates and attendance at meetings during the year, is set out below:

| Members (Biographies appear on pages 46 and 47) | Committee member since | Attendance at meetings in 2012 |
|---|---|---|
| John Whybrow (Chairman) | 12 October 2010 | 6/6 |
| Andrew Allner | 12 October 2010 | 6/6 |
| Gerald Ermentrout | 12 October 2010 | 5/6 |
| Adrian Auer | 4 May 2011 | 6/6 |
| Adrian Whitfield[1] | 4 May 2011 | 3/3 |
| Philana Poon[2] | 29 June 2012 | 3/3 |

Notes:

1. Resigned 25 May 2012.
2. Appointed 29 June 2012.

Other attendees at Committee meetings:

| Attendee (No Director is involved in any decision surrounding his/her own pay) | Regular attendee | Attends at Chairman's invitation |
|---|---|---|
| Company Secretary | ✓ | |
| New Bridge Street (retained independent adviser) | ✓ | |
| Chief Executive Officer | | ✓ |
| Group Human Resources Director | ✓ | |
| Chief Financial Officer | | ✓ |

The Board continues to believe that John Whybrow's knowledge of AZ remuneration matters, coupled with his general experience in this specialised area built up over a number of years in previous roles held as Remuneration Committee Chairman of other listed companies, provides significant benefits to the Committee. Major shareholders have expressed no concerns with this ongoing arrangement. For these reasons, the Board has decided that John Whybrow should remain Chairman of the Committee at this stage in the Company's development. Apart from this, the Committee's composition and operation is fully compliant with the Code.

The Committee operates under the delegated authority of the Board and within clearly defined terms of reference which are subject to annual review. The latest version of these is available on the Company's website at www.azem.com. The Company Secretary acts as Committee Secretary.

## Summary of main responsibilities and activities of the Committee

- To make recommendations to the Board on the Company's framework and broad policy for the remuneration of the Executive Directors, senior management and Chairman, being those persons who have a significant influence over the Company's achievement of its strategic objectives;
- To consider and determine the Chairman's fee and the total individual remuneration packages of the Executive Directors and, as recommended by the Chief Executive Officer, the senior management team. This includes recruitment terms, benefits, employment conditions, pension rights, annual bonuses, long term incentives (including share options and other share awards), compensation payments and severance terms;
- To approve the design of, and determine the targets and awards for, any performance-related remuneration schemes for the executive and senior management;
- To review and note annually the pay and employment conditions existing elsewhere across the Group when considering executive pay;
- To oversee any major changes in employee benefits and to determine the policy for, and scope of, pension arrangements throughout the Group; and
- To review, determine and administer awards made under the Company's share incentive plans and employee share-based incentive schemes.

## Advisers

New Bridge Street ("NBS"), an Aon Hewitt company, acts as the Committee's principal independent remuneration adviser. NBS is a member of the Remuneration Consultants Group and has signed up to its Code of Conduct.

Other than in relation to advice on remuneration, NBS does not provide any other services to the Group. (Aon plc also provides insurance brokerage and related services to the Group). The terms of engagement for NBS are available from the Company Secretary on request.

The Committee has also received advice and assistance during the year from:

- Clifford Chance and Deloitte concerning the operation of the AZ Long Term Incentive Plan ("LTIP") – they also act as the Company's corporate legal advisers and the external auditor respectively; and
- the Chief Executive Officer, the Chief Financial Officer, the Group Human Resources Director and the Company Secretary, each of whom have provided internal support and advice, but not in relation to their own pay.

The Committee constantly monitors existing cross relationships and is confident that none of them have or are likely to result in a conflict of interest situation arising.

## Executive remuneration policy

The Committee's key objectives when setting the executive remuneration policy (which also applies to senior management) are to:

- ensure clear linkage with the Company's overall corporate strategy, whilst maintaining the appropriate risk profile;
- set competitive, but not excessive, total remuneration packages which will attract, retain and motivate high calibre executives to run the Company successfully;
- create alignment with shareholders' interests through the balanced design and implementation of both short and long term performance-related incentive plans; and
- be cognisant of pay and performance conditions within the Group and in the wider employment environment when making decisions on executive remuneration.

The table below demonstrates how the executive remuneration policy links into the overall corporate strategy:

| Element of Remuneration Package | Strategic Purpose |
|---|---|
| Base Salary (fixed) | To attract and recognise the value of an individual's skills, experience and knowledge, being mindful of the job holders' location. |
| Benefits (fixed) | To provide a range of benefits on a cost-effective basis which are aligned with competitive market practice in the various geographies. |
| Pension (fixed) | To provide retirement benefits on a cost-effective basis which are aligned with competitive market practice in the various geographies. |
| Annual Bonus (variable) | To provide an incentive and reward payable for the achievement of specific short term goals and objectives covering key financial metrics and personal performance contributions required to deliver the Company's annual operating plan. |
| LTIP (variable) | To provide an incentive and reward payable for the achievement of specific long term goals covering key financial metrics required to deliver the Company's strategic plan and aligned to shareholder value creation. |

## Risk

The Committee recognises its responsibility to maintain an effective system of control and risk management with regards to remuneration policy. The Committee regularly reviews the incentive plans to ensure they operate within an appropriate risk framework. The Committee has conducted a review of risk within the remuneration policy to ensure that it does not encourage undue risk taking by the Executive.

When setting and measuring performance targets, the Committee is mindful of environmental, social and governance issues ("ESG") and considers that the current incentive structures do not encourage excessive risk taking and will not reward in the event of a negative ESG incident.

Governance
# Remuneration report continued

## Executive Directors' remuneration

The remuneration of the Executive Directors is currently structured to comprise each of the five elements of remuneration referred to above.

During the year, the Committee commissioned a further market competitive review of all executive and senior management roles and remuneration given the Group's now established position as an international UK listed company. The results showed that the Chief Executive role remained substantially behind the market in terms of base salary considering the size and performance of the Company. This data (which also took into account the role, responsibilities and experience of the individual), provided a useful reference point to the Committee in its subsequent review of the current remuneration packages in place for the executive and senior management team, and any changes to be considered and determined for 2013 (as detailed below).

The Group has a diverse workforce operating across a number of geographic locations, particularly Asia, with the majority of salaries set locally to meet these needs. For certain positions, the Group competes globally for talent and consequently those salaries (and remuneration packages) are set by reference to the global market rather than local factors. AZ employs an experienced, highly educated and multicultural workforce with which the Company maintains good relationships. Just over half of our employees hold university and/or postgraduate degrees and some 40% have worked for us for more than 10 years. For 2013, average salary increases were determined at 6%, 3% and 3% across Asia, Europe and USA respectively. The Committee is mindful of pay and employment conditions elsewhere in the Group and internal relativities which are created when setting remuneration packages.

### Base salary

Base salaries represent a fixed element of remuneration for the Executive Directors and are reviewed and determined annually by the Committee. The intention is to set salaries at or around mid-market levels comparable to similar roles in similar size and type companies. Whilst the default policy is to benchmark against the local market, in cases where it is necessary to recruit an individual from a different country, the appropriate benchmark will be against the mid-market salary in that individual's home country or against international market norms for the position.

The base salaries which applied for the year ended 31 December 2012, as disclosed in last year's Report, were:

- Geoff Wild, Chief Executive Officer: $586,500 (gross); and

- Mike Powell, Chief Financial Officer: £310,000 (gross).

The market review undertaken by the Committee during the year utilised two comparator groups, one being based on similar sized companies with comparable business operations and with similar requirements for top talent (the "sector" group), and one based on pan-sector companies of a similar size and complexity (the "general" group). The market data highlighted that Geoff Wild's current salary was positioned at below the lower quartile of both comparator groups.

The Committee is mindful that the use of benchmark data in itself does not provide a definitive answer to setting base salaries. However, it does provide context when considering other factors such as:

- the role, responsibilities, skills and experience of the individual;
- personal and corporate performance;
- pay and employment conditions elsewhere in the Group; and
- internal pay relativities.

Based on the results of the market review undertaken, and taking into account the postponement of the planned second phase increase in Mr Wild's salary in 2012, his continued strong personal performance (as well of that of the Company) and the broad level of support received during consultation with major shareholders, the Committee decided to award a 20% salary increase to Mr Wild for 2013 with a view to moving him further towards a mid-market competitive position. The Committee believes that the timing of this increase is appropriate as it reflects the sustained progress and performance of both Mr Wild and the Company since IPO and is aligned to the pursuit of further growth in accordance with the Company's strategy.

It should be noted that even after this increase, Mr Wild's salary remains below the median of both the sector group and the general group. While the Committee does not expect to make further significant increases to the CEO's pay in the near future, it does expect, over the next 2-3 years (assuming normal circumstances apply), to increase the CEO's salary to the mid-market level. This will be through annual mid-single digit percentage increases, depending on individual and corporate performance, as well as general pay and employment conditions existing elsewhere in the wider Group.

Following the market review, Mr Powell's salary was considered to be broadly mid-market competitive although his benefits were slightly below this level. Given the quality of his performance, and recognising this was his first pay review since he joined the Company on 1 August 2011, the Committee awarded him a 5% salary increase which is in line with that granted to other strong performers in the wider Group.

### Pensions and Benefits

The intention remains to ensure that a market competitive, yet cost-effective arrangement (for both Executive Directors and the Company), is implemented.

The Committee provides defined contribution type pension arrangements for the Executive Directors. During 2012, this represented a 15% of salary contribution for each of them but which will rise to 20% of salary for Mr Powell from 1 January 2013.

For Mr Wild, his contribution is paid into the Hong Kong mandatory provident fund scheme in which he participates through his local AZ employer.

For Mr Powell, his contribution is made in the form of a salary supplement paid directly to him.

As regards benefit entitlements, and pursuant to the terms of their respective Service Agreements:

- Mr Wild receives private health insurance, reimbursement of the costs associated with the purchase or lease of a car; accommodation rental reimbursement up to a maximum of HK$75,000 per month and financial and estate planning assistance; and
- Mr Powell receives private health care insurance and, from 1 January 2013, critical illness and long term disability cover and a car allowance of £15,000 (gross) per annum. During the year, the residual £6,823 cost associated with Mr Powell's original tax-free relocation package provided to him on joining AZ was incurred and paid.

## Annual bonus

Executive Directors are eligible to participate in the discretionary Global Bonus Plan ("GBP") which also operates to include all management levels. The GBP is designed to drive and reward the short to medium term financial and operating performance of the Group which should, in turn, lead to the generation of sustained long term returns to shareholders. The award and value of any bonus received is based on demanding performance measures and objectives set by the Committee in advance.

In respect of the 2012 GBP:

- the Executive Directors had a maximum bonus opportunity of 120% of base salary, with 60% of base salary payable for on-target performance;
- within the 60% bonus, 36% is payable for achievement against budgeted EBITDA, 12% for achievement against budgeted cash flow and the remaining 12% for achievement against pre-set personal goals and objectives ("G&Os");
- the Committee has the ability to apply a flexing factor to the personal bonus element. This can be up to 1.2 and will be determined by a qualitative assessment of achievement against individual performance, including G&Os. Any flexing factor is limited to the extent that the total bonus payable cannot exceed the maximum bonus opportunity; and
- the Committee toughened the targets that needed to be achieved for a bonus to be paid. In particular, in order to reward incremental Company performance year-on-year, the EBITDA metric only commences a bonus payout where the performance meets a minimum threshold (an "underpin") being the higher of 90% of the 2012 budget target or the 2011 actual. The cash flow metric commences a bonus payout where the performance meets 90% of the 2012 budget target; and the personal performance element of the bonus only qualifies for payment if the commencement threshold for one or other of the financial metric targets is missed. No bonus is payable if both financial metric targets are missed.

The table below shows the extent to which the targets were met in 2012 and the actual bonus award as a percentage of salary in comparison with the threshold, on-target and maximum levels:

| Performance Measure (Weighting) | Threshold | On-target | Maximum | 2012 Actual CEO | 2012 Actual CFO |
|---|---|---|---|---|---|
| EBITDA (60%) | 18% | 36% | 72% | **30.5%** | |
| Cash Flow (20%) | 6% | 12% | 24% | **17.5%** | |
| G&Os (20%) | 6% | 12% | 24% | 11.1% | 12.0% |
| Flexing Factor | | | | 1.20 x **13.3%** | 1.18 x **14.2%** |
| **Total (100%)** | **30%** | **60%** | **120%** | **61.3%** | **62.2%** |

Within the context of a difficult macroeconomic environment, the Company has performed well in terms of sales and EBITDA. Cash generation has remained strong and exceeded the budgeted figure. As a result, the financial metrics were achieved in aggregate against on-target Company performance.

The Committee reviewed and assessed the individual performance of both Mr Wild and Mr Powell both generally and against their pre-set G&Os and determined that a flexing factor of 1.20 and 1.18 respectively should be applied to the element of bonus related to personal G&Os only. Mr Wild and Mr Powell therefore earned a bonus in 2012 of US$359,642 and £192,696 respectively.

In respect of the 2013 GBP:

- the annual bonus structure will remain broadly the same with EBITDA, cash flow and personal performance targets continuing to be weighted on a 60:20:20 basis;
- the range under which the EBITDA targets will payout has been narrowed to 95% of budget for threshold and 110% for the maximum (previously 90% and 120% respectively). This change recognises some maturity in the Company's sales growth and is considered a realistic stretch expectation for the forthcoming year. The range around budget will be reviewed on an annual basis to ensure it remains appropriate in accordance with the expected growth profile at that time;
- the cash flow target will continue to be based upon a 90% of budget threshold with a 120% of budget maximum. This wider range reflects the fact that cash flow can be more variable than EBITDA, particularly due to timing differences; and
- there are no changes to the structure of the personal performance measures, and the G&Os targets have been set in accordance with the Performance Management Programme and pursuant to the targeted achievement of the 2013 budget.

# Governance
## Remuneration report continued

### Long Term Incentive Plan ("LTIP")
The LTIP has been running for three years with its purpose to promote loyalty, aid retention, reward superior performance and align the interests of the executives with those of shareholders.

Awards made under the LTIP can be in the form of either market-price options and/or performance shares and have a 10-year life. They will normally vest after three years from the date of grant, subject to continued employment and, at least in the case of Executive Directors and management, satisfaction of pre-determined performance conditions. Except in exceptional circumstances, no participant may receive grants of market-price options or performance shares with an annual value in excess of 400% and 200% of salary respectively. Awards under the LTIP, including the determination of any relevant performance conditions, will be considered and determined on an annual basis at the discretion of the Committee.

In 2012, in order to reflect two key financial measures linked to the corporate strategy, share awards were granted with a total shareholder return ("TSR") performance condition and market-price option awards were granted with a basic earnings per share ("EPS") performance condition.

In April 2012, the following LTIP awards were made to the Executive Directors:

| | TSR Shares (% of salary) | EPS Market-Price Options (% of salary) |
|---|---|---|
| Geoff Wild | 100% | 140% |
| Mike Powell | 80% | 100% |

The above awards were made within the Committee's normal annual grant policy range for Executive Directors which is 150%–250% of salary in aggregate. Mr Wild's award was at the upper end of the range in part recognition for the postponement of the planned second phase increase in his salary in 2012 (as referred to above).

The TSR performance condition will measure the Company's TSR performance relative to an identified group of comparator companies over a fixed three-year performance period (commencing on the first day of the quarter in which the awards were granted).The TSR peer group of international companies used for this award (and previously) is listed below:

| | | |
|---|---|---|
| Air Liquide | Johnson Matthey | Photronic |
| ATMI | JSR Corporation | Symrise |
| Cabot Corporation | Lonza Group | Tokyo Okha Kogyo |
| CHR Hansen Holding | Memc Elt. Materials | Umicore |
| Corning | Nitto Denko | Victrex |
| Croda International | Novozymes | Wacker Chemie |
| Givaudan 'N' | Park Electrochemical | |

TSR is measured using a three-month average at the start and end of the performance period. Awards will vest in accordance with the following schedule:

| Company's TSR performance relative to that of the comparator group of companies during the three-year period 1 April 2012 – 31 March 2015 | Percentage of share award that vests |
|---|---|
| Below median ranking | 0% |
| Median ranking | 25% |
| Upper quartile ranking (and above) | 100% |
| Between median and upper quartile ranking | Between 25% and 100% on a straight-line basis |

However, regardless of the TSR performance of the Company, no part of an award may vest unless the Committee is satisfied that the underlying financial performance of the Company over the performance period has been satisfactory.

The EPS performance condition measures the growth target for this award which will vest in accordance with the following schedule:

| Achievement of compound annual growth in EPS during the three-year financial period 2012-2014 | Percentage of option award that vests |
|---|---|
| Below 6% | 0% |
| 6% | 25% |
| 12% | 100% |
| Between 6% and 12% | Between 25% and 100% on a straight-line basis |

It is the Committee's intention to continue making annual grants of market-price options and/or performance shares to the Executive Directors within its normal grant policy range of 150%–250% of salary in aggregate. The Committee will continue to review both the use of EPS and TSR performance measures, and the levels of awards made, to ensure that the appropriate balance of incentives is maintained.

## Share Plans

### LTIP awards made to Directors

The following awards have been made and are outstanding to the Executive Directors under the LTIP:

| EPS Market-Price Options | Date of grant | Award over Ordinary shares | Total held at 31 December 2012 | Exercise price per share (pence) | Date from which first exercisable | Award expiry date |
|---|---|---|---|---|---|---|
| Geoff Wild | 3 November 2010 | 331,722[1] | 331,722 | 240 | 3 November 2013[5] | 2 November 2020 |
| | 10 April 2012 | 176,662[3] | 176,662 | 293 | 10 April 2015[5] | 9 April 2022 |
| Mike Powell | 31 August 2011 | 274,336[2] | 274,336 | 226 | 31 August 2014[5] | 30 August 2021 |
| | 10 April 2012 | 105,802[3] | 105,802 | 293 | 10 April 2015[5] | 9 April 2022 |

| TSR Performance Shares | Date of grant | Award over Ordinary shares | Total held at 31 December 2012 | Exercise price per share | Date of vesting |
|---|---|---|---|---|---|
| Geoff Wild | 8 April 2011 | 64,118[4] | 64,118 | n/a | 8 April 2014[5] |
| | 10 April 2012 | 126,187[4] | 126,187 | n/a | 10 April 2015[5] |
| Mike Powell | 31 August 2011 | 68,584[4] | 68,584 | n/a | 31 August 2014[5] |
| | 10 April 2012 | 84,642[4] | 84,642 | n/a | 10 April 2015 |

Notes:

1. EPS growth target based on the achievement of compound annual growth in EPS during the three-year financial period: 16% or higher = 20% of awards vest, 19% or higher = 40% of awards vest, 22% or higher = 60% of awards vest, 25% or higher = 100% of awards vest. Straight-line vesting takes place between these points.
2. EPS growth target based on the achievement of compound annual growth in EPS during the three-year financial period: 16% or higher = 25% of awards vest, 19% or higher = 50% of awards vest, 22% or higher = 75% of awards vest, 25% or higher = 100% of awards vest. Straight-line vesting takes place between these points.
3. EPS growth target as described on page 68: 6% compound annual growth in EPS = 25% vests, rising on a straight-line basis to 100% vesting for 12% compound annual growth in EPS.
4. Relative TSR measure as described on page 68, against a bespoke group of international comparators measures over a three-year performance period. 25% of the award vests for a median ranking position, rising on a straight-line basis to 100% vesting for upper quartile ranking.
5. Or later subject to the Committee's determination that either the performance conditions have been satisfied or the date falls within a close or prohibited period.

The Committee regularly monitors existing awards to assess expected vesting and communicates this information to participants. Based on the Company's performance to 31 December 2012, the Committee considers that the main 2010 and 2011 EPS option awards are on track to deliver full vesting. However, these awards have a cliff-edge vesting condition and no vesting will take place without continued performance in 2013. Similarly, the 2011 TSR share awards are also on track to deliver full vesting. The Committee considers that to date, an insufficient proportion of the performance period has elapsed to provide an accurate estimate of the potential vesting of the 2012 LTIP awards.

In addition to the above LTIP awards, Mr Powell was granted on 31 August 2011 a restricted stock award over 112,654 Ordinary shares in part recognition for the equity incentives that he forfeited upon termination of his previous employment. The first 50% tranche of this award vested on 3 September 2012 (originally due to vest on 1 August 2012 but delayed due to Company being in a close period) and the residual 50% will vest on 2 September 2013 (originally 1 August 2013 but amended due to the Company expecting to be in a close period at that time), subject to Mr Powell's continued employment at that date. Upon the first tranche vesting, Mr Powell realised a gain of £175,577 (made up as to 56,327 vested shares x £3.117 – being the market price of an AZ share at the date of vesting). He immediately sold sufficient shares to meet his Income Tax and National Insurance liabilities with the remaining 26,934 shares being retained. This retention amount exceeds the minimum expectation set out in the Committee's Share Ownership Guidelines (see overleaf).

# Governance
## Remuneration report continued

### Share Ownership Guidelines

The Committee has put in place share ownership guidelines in order to help align the long term interests of the Executive Directors with those of shareholders. Their level of holding against the guidelines at 31 December 2012 was as follows:

| Position | Share Ownership Guideline (% of salary) | Value of shares held at 31 December 2012 (% of salary[1]) |
|---|---|---|
| Chief Executive Officer | 150% | 636% |
| Chief Financial Officer | 100% | 20% |

Notes:

1. Shares held as a percentage of salary are determined pursuant to the terms of the share ownership guidelines. The actual shareholding of each Executive Director is shown in the Directors' Report on page 49.

It is anticipated that the required shareholding level be reached during a period of between 3-5 years from the individual's first LTIP grant and that, while the guideline level has not been attained, at least 50% of the net of tax vested shares/exercised options (i.e. half of shares held after settling income tax, social security liabilities and transaction costs) will be retained. Vested performance share awards (but not options) may count towards the requirement. Details of the Executive Directors' outstanding LTIP awards are shown in the share plan table on page 69.

Other members of the Global Management Team are also subject to a 100% of salary share ownership guideline.

The Committee monitors individual progress towards the share ownership guidelines ahead of each annual LTIP award consideration.

### Employee ShareMatch Plan

The Committee and the executive believe in the strong motivational impact that employee share ownership can create. Therefore, the Company introduced a new Employee ShareMatch Plan in 2012 which will deliver one free matching Ordinary share for every four Ordinary shares purchased up to a certain maximum investment limit per employee per invitation, initially set at £4,000. The take-up of the first invitation under the Plan was 31% of eligible employees and the average investment was £2,074. The matching shares will vest on the first anniversary of the contract commencement on 4 May 2013; the free ShareMatch liability, to be satisfied through market-purchased shares (including shares currently held in the Company's Employee Benefit Trust as detailed below), is 44,126 Ordinary shares. The Committee will continue to encourage wider share ownership amongst employees and to this end, it is intended that an annual invitation will be made under the ShareMatch Plan in all territories where the Company has an operating presence and where local securities laws and regulations permit such a Plan to operate.

A more traditional ShareSave Plan (and 5% dilution authority) was adopted by shareholders on 27 October 2010 but the Company has not used it, and does not currently intend to make use of it, because of the significant securities laws complications which exist in various Asian territories and the high costs of operating such a plan.

### Dilution

The number of new Ordinary shares that may be issued under the LTIP and under any other executive share plan of the Company in any 10-year period commencing from Listing may not exceed 5% of the Company's issued share capital at any time.

The number of new Ordinary shares that may be issued under all the Company's employee share plans under grants made in any 10-year period commencing with Listing may not exceed 10% of the Company's issued share capital at any time.

The Company's aggregated dilution level at 31 December 2012 for this restrictive purpose was 4,773,376 shares, representing 1.3% of the issued share capital. This excludes (as permitted) the residual market-price options granted without performance conditions to certain employees over 746,328 Ordinary shares at Listing on 3 November 2010.

Any Ordinary shares issued out of treasury will count towards the above dilution limits for so long as this is required by institutional investor guidelines.

The Company has in place an off-shore discretionary Employee Benefit Trust ("EBT") which is able to buy Ordinary shares in the Company and supply them in satisfaction of the future vesting of awards under the LTIP, the Employee ShareMatch Plan and Mr Powell's restricted stock award. Pursuant to the Remuneration Committee's approved hedging strategy, the EBT completed (at the Company's request), the market purchase of 1,325,441 AZ Ordinary shares in the second half of 2012 using some £5.0m of unallocated EBT cash. At the year end, the EBT held 1,269,114 AZ Ordinary shares. The EBT has also waived its right to receive all and any dividends paid on the shares in holds in the Company from time to time.

## Executive Directors' Service Agreements

Details of the Executive Directors' Service Agreements are summarised below. Mr Wild's agreement is with AZ Electronic Materials Hong Kong Services Limited and Mr Powell's agreement is with AZ Electronic Materials Services Limited.

| | Date of appointment | Effective date of service agreement | Unexpired term | Notice period by Company | Notice period by Director | Current Age |
|---|---|---|---|---|---|---|
| Geoff Wild | 1 January 2010 | 3 November 2010 (Supplemental Agreement 18 May 2012) | Rolling contract | 12 months | 12 months | 56 |
| Mike Powell | 1 September 2011 | 1 August 2011 (Supplemental Agreement 23 October 2012) | Rolling contract | 12 months | 6 months | 45 |

During the year, the Committee reviewed the Executive Directors' service agreements against best market practice. As a result, it was felt appropriate to increase the notice period from the Company in each case from 6 months to the market standard of 12 months and to increase the notice period to be served on the Company by Mr Wild from 6 months to 12 months. This was also a reflection of the strong performance in role by both Executives and the Committee's determination to retain their services for the long term. As part of the revised contract negotiations for Mr Wild, the ability for him to terminate his employment immediately without notice (by way of a payment to the Company in lieu thereof) was removed and certain other minor amendments made at the same time (for example, a reference to a specific level of on-target bonus entitlement and a statement that participation in the annual bonus plan was discretionary, was also removed).

## Termination of employment

AZ may terminate Mr Wild's Service Agreement without notice if a payment in lieu of notice is made, calculated by taking the average monthly total of his salary and benefits (excluding bonus and pension contributions) over the 12-month period directly preceding termination. If Mr Wild's employment is terminated by AZ "without cause", he is entitled to a severance payment equal to 100% of base salary. Any such severance payment would be paid over 12 months following the date of termination in four equal quarterly instalments.

AZ may terminate Mr Powell's Service Agreement without notice if a payment in lieu of notice is made equal to 12 months' base salary.

Save as above, there are no special provisions for Executive Directors with regard to compensation in the event of loss of office. In the event of the employment of an Executive Director being terminated by AZ, the Committee would, having regard to the circumstances, pay due regard to best practice and take into account any duty or obligation on the individual to mitigate his loss.

## Outside interests

It is the Company's policy that Executive Directors may accept one external non-executive directorship provided that such appointment does not prejudice or conflict with their ability to fulfill their executive duties with the Company and that they have obtained the prior approval of the Chairman. Mr Wild currently holds an external non-executive directorship with Materion Corporation in the US for which he is entitled to retain his annual fee payment of US$70,000 per annum. In 2012, he also received a restricted stock award to the value of US$65,000. Mr Powell does not hold any external positions.

## Non-Executive Directors

The remuneration of the Non-Executive Directors (save for the Chairman) is reviewed periodically and determined by the Board. In determining their fees, the time and responsibilities involved (including whether the role includes the Chairmanship of any Board Committee), and the fee levels paid in comparable UK listed companies, are taken into account.

No director is present at meetings where their own remuneration is under discussion. In the case of the Chairman, and the Remuneration Committee's deliberation and determination of his fees, the discussion is chaired by Andrew Allner who, from 1 January 2012, was appointed Senior Independent Director.

The annual base fee payable in 2012 for John Whybrow as Company Chairman was £225,000 and for all other Non-Executive Directors was £55,000. An additional annual fee of £20,000 is payable to the Chairman of the Audit Committee (Andrew Allner), £13,000 to the Chairman of the Remuneration Committee (John Whybrow) and £10,000 to the Senior Independent Director (Andrew Allner). Details of the actual fees paid to the Non-Executive Directors in 2012 are shown in the remuneration table on page 73.

For 2013, and post review, the Board and the Committee respectively determined that the current fee structure and fee levels paid to the Non-Executive Directors and the Chairman remained appropriate and market competitive. Therefore, in normal circumstances, it is proposed that the current fee structure will remain unchanged for the next two years.

# Governance
## Remuneration report continued

The Non-Executive Directors do not have Service Agreements as they are not employees. Instead, their duties and responsibilities are governed by individual Letters of Appointment which they have entered into with the Company, summary details of which are given below. The Letters of Appointment of the Non-Executive Directors, and the Service Agreements of the Executive Directors, are available for inspection at the Company's registered office during normal business hours.

| | Date of Letter of Appointment | Effective date of appointment | Term of appointment | Notice period by Company or Director |
|---|---|---|---|---|
| John Whybrow | 30 July 2010 | 1 September 2010 | To 31 August 2013 | 1 month |
| Andrew Allner | 9 September 2010 | 1 October 2010 | To 30 September 2013 | 1 month |
| Gerry Ermentrout | 28 October 2010 | 28 October 2010 | To 11 October 2013 | 1 month |
| Philana Poon | 24 May 2012 | 29 June 2012 | To 24 April 2013 | 1 month |
| Adrian Whitfield[1] | 10 February 2011 | 4 May 2011 | To 4 May 2014 | 1 month |
| Adrian Auer | 23 March 2011 | 4 May 2011 | To 4 May 2014 | 1 month |
| David Price | 23 March 2011 | 4 May 2011 | To 4 May 2014 | 1 month |

Notes:
1. Resigned 25 May 2012

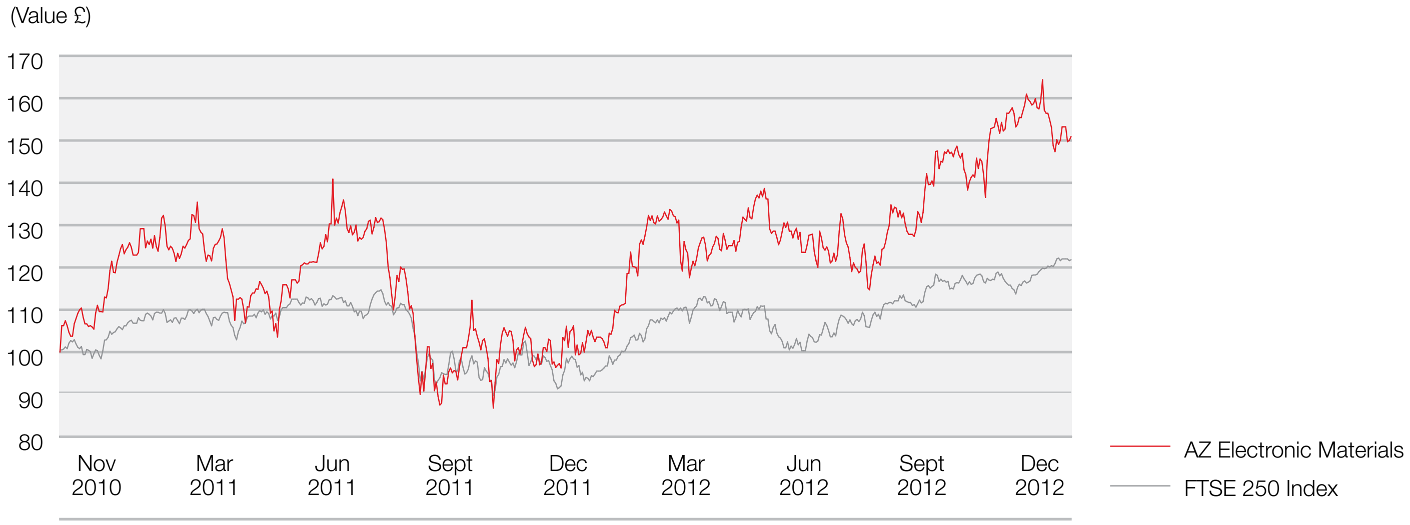
### Share Price Performance Graph

The graph below shows the Company's performance, measured by Total Shareholder Return, compared with the performance of the FTSE 250 Index for the period from 3 November 2010 (the date of the Company's Listing) through to 31 December 2012. This Index has been chosen as a comparator as it represents a broad equity index of which the Company is a constituent member.

This graph shows the value, at 31 December 2012, of £100 invested in AZ Electronic Materials S.A. at the Offer Price of 240 pence per share on Listing, compared with the value of £100 invested in the FTSE 250 Index on that same date.

### Total Shareholder Return

Source: Thomson Financial (Datastream)




### Committee evaluation

As part of the inaugural Board evaluation process, the Committee undertook its own performance evaluation. This confirmed that the Committee was both effective and efficient in its operation and leadership, with no material areas identified for improvement or attention. Details of the process and its outcome are provided within the Corporate Governance Report on pages 53 to 59.

## SECTION B: AUDITED INFORMATION

The individual and total remuneration of the Company's Directors who served during the period from 1 January, or the date of appointment (if later), to 31 December 2012 is shown in the table below.

| US$'000[1] | Salary | Fees | Pension | Benefits | Bonus | **Total 2012** | Total 2011 |
|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | |
| Geoff Wild[2] | 586 | – | 88 | 120 | 360 | **1,154** | 1,134 |
| Mike Powell[3] | 490 | – | 73 | 3 | 304 | **870** | 288 |
| **Non-Executive Directors** | | | | | | | |
| John Whybrow | – | 376 | – | – | – | **376** | 382 |
| Andrew Allner[4] | – | 134 | – | – | – | **134** | 120 |
| Gerald Ermentrout | – | 87 | – | – | – | **87** | 88 |
| Adrian Auer | – | 87 | – | – | – | **87** | 59 |
| David Price | – | 87 | – | – | – | **87** | 59 |
| Philana Poon[5] | – | 41 | – | – | – | **41** | – |
| **Former Directors** | | | | | | | |
| Ken Greatbatch[6] | – | – | – | – | – | **–** | 410 |
| Franck Falézan[7] | – | – | – | – | – | **–** | 88 |
| Jean-François Félix[7] | – | – | – | – | – | **–** | 88 |
| Adrian Whitfield[8] | – | 36 | – | – | – | **36** | 59 |
| **Total** | **1,076** | **848** | **161** | **123** | **664** | **2,872** | **2,775** |

Notes:

1. The information in this table has been translated into US Dollars based on the average exchange rates existing over the relevant period of service or date of payment, as appropriate.
2. In relation to Mr Wild: (i) he was entitled to a 15% of salary employer's pension contribution. This contribution is paid directly in the local mandatory provident fund scheme (a money purchase arrangement) in which he participates; and (ii) his benefit entitlements comprise private health care insurance, reimbursement of the costs associated with the purchase or lease of a car, accommodation rental costs up to a maximum of HK$900,000 (US$116,000) per annum and financial and estate planning assistance.
3. In relation to Mr Powell: (i) he was entitled to a 15% of salary employer's pension contribution. These monies are satisfied by means of a salary supplement paid directly to him; (ii) his benefit entitlements comprised private health care insurance; and (iii) his 2011 relocation to the London area was a condition of his job offer and in respect of which he was granted a tax-free relocation package of up to US$40,000 for physical relocation costs, US$80,000 for stamp duty paid on the purchase of new property and one month's hotel accommodation costs. In the first quarter of 2012, £6,823 (US$10,777) of such costs were incurred, claimed and paid representing completion of his full relocation entitlement. These monies do not represent remuneration and therefore are not included in the table above.
4. In relation to Mr Allner: he became entitled to an additional £10,000 (US$15,795) per annum fee payment as a result of his being appointed to the new position of Senior Independent Director from 1 January 2012.
5. In relation to Ms Philana Poon: she was appointed a Director on 29 June 2012. Her Non-Executive fee therefore relates to the period from the date of her appointment to 31 December 2012.
6. In relation to Ken Greatbatch: he resigned from the Board and retired from the Company's employment as Chief Financial Officer on 31 August 2011. His remuneration for last year therefore relates to this period of service from 1 January 2011 to the date of his retirement.
7. In relation to Messrs Falézan and Félix: they each resigned from the Board on 31 December 2011. Their 2011 comparative Non-Executive fee entitlement was not paid to them directly but to their employers, The Carlyle Group and Vestar Capital Partners respectively (each of which was a major shareholder in the Company until 31 December 2011) and for whom Messrs Falézan and Félix acted as their respective nominee Board representative.
8. In relation to Mr Whitfield: he stepped down from the Board on 25 May 2012. His Non-Executive fee therefore relates to the period from 1 January 2012 to the date of his leaving.

The closing market price of the Company's Ordinary shares on 31 December 2012 was £3.493 per share and during the year ranged between £2.475 and £3.803 per share.

Details of the Directors' beneficial and non-beneficial interests in the Ordinary share capital of the Company are set out in the Directors' Report on page 49.

This Remuneration Report has been approved and adopted by the Board on the recommendation of the Committee.

**John Whybrow**
Chairman, Remuneration Committee

# Report of the réviseur d'entreprises agréé

To the Shareholders of
AZ Electronic Materials S.A.
32 – 36, Boulevard d'Avranches
L-1160 Luxembourg

## Report on the consolidated financial statements

Following our appointment by the General Meeting of Shareholders dated 2 May 2012, we have audited the accompanying consolidated financial statements of AZ Electronic Materials S.A., set out on pages 75 to 113, which comprise the consolidated balance sheet as at 31 December 2012 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Responsibility of the Board of Directors for the consolidated financial statements

The Board of Directors is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted in the European Union, and for such internal control the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Responsibility of the réviseur d'entreprises agréé

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted for Luxembourg by the *Commission de Surveillance du Secteur Financier*. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the judgement of the *réviseur d'entreprises agréé*, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the *réviseur d'entreprises agréé* considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of AZ Electronic Materials S.A. as at 31 December 2012, and of its consolidated financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in the European Union.

## Report on other legal and regulatory requirements

The Management Report set out on pages 48 to 51, which is the responsibility of the Board of Directors, is consistent with the consolidated financial statements.

The accompanying Corporate Governance Report on pages 53 to 59, which is the responsibility of the Board of Directors, includes the information required by the listing rules of the UK Listing Authority and by the law of 19 December 2002 on the commercial and companies register and on the accounting records and annual accounts of undertakings, as amended and the description included with respect to Article 68b is paragraphs c and d of the aforementioned law is consistent with the consolidated financial statements.

For Deloitte Audit,
Cabinet de révision agréé

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**John Psaila**
Réviseur d'entreprises agréé
Partner

560, rue de Neudorf
L-2220 Luxembourg
Grand Duchy of Luxembourg

18 February 2013

# Consolidated income statement

| Continuing operations | Notes | Year ended 31 December 2012 US$m | Year ended 31 December 2011 US$m |
|---|---|---|---|
| **Revenue** | 4 | **793.9** | 791.8 |
| Cost of goods sold | | **(420.1)** | (421.2) |
| **Gross profit** | | **373.8** | 370.6 |
| Operating costs | 8 | **(223.1)** | (219.9) |
| **Operating profit** | | **150.7** | 150.7 |
| Investment income | 9 | **1.7** | 1.6 |
| Finance costs | 10 | **(23.3)** | (26.7) |
| **Profit before tax** | 5 | **129.1** | 125.6 |
| Tax | 11 | **(46.2)** | (29.1) |
| **Profit for the year from continuing operations** | | **82.9** | 96.5 |
| Attributable to: | | | |
| **Equity holders of AZ Electronic Materials S.A.** | | **82.9** | 96.5 |
| **Earnings per share from continuing operations** | | | |
| Basic (cents) | 13 | **21.8** | 25.3 |
| Diluted (cents) | 13 | **21.7** | 25.3 |

The accompanying Notes are integral to these financial statements.

# Consolidated statement of comprehensive income

| | Notes | **Year ended 31 December 2012 US$m** | Year ended 31 December 2011 US$m |
|---|---|---|---|
| **Profit for the year** | | **82.9** | 96.5 |
| Cash flow hedges: net gains arising during the year | 21 | **3.0** | 8.8 |
| Exchange differences on translation of foreign operations | 21 | **(29.5)** | 21.5 |
| Other comprehensive (loss)/income | | **(26.5)** | 30.3 |
| Tax charge relating to components of other comprehensive income | 21 | **(1.5)** | (1.0) |
| Other comprehensive (loss)/income for the year | | **(28.0)** | 29.3 |
| **Total comprehensive income for the year** | | **54.9** | 125.8 |
| Attributable to: | | | |
| **Equity holders of AZ Electronic Materials S.A.** | | **54.9** | 125.8 |

The accompanying Notes are integral to these financial statements.

# Consolidated balance sheet

| | Notes | As at 31 December 2012 US$m | As at 31 December 2011 US$m |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Goodwill | 14 | **409.0** | 413.4 |
| Intangible assets | 15 | **550.7** | 665.5 |
| Property, plant and equipment | 16 | **232.4** | 224.2 |
| Investments | 17 | **6.4** | 6.4 |
| Deferred income tax assets | 24 | **16.3** | 12.3 |
| Derivative financial assets | 25 | **0.1** | – |
| | | **1,214.9** | 1,321.8 |
| **Current assets** | | | |
| Inventory | 18 | **77.0** | 79.5 |
| Trade and other receivables | 19 | **161.8** | 157.5 |
| Derivative financial assets | 25 | **–** | 0.7 |
| Current income tax assets | 11 | **2.5** | 1.8 |
| Cash and cash equivalents | 19 | **109.6** | 148.0 |
| | | **350.9** | 387.5 |
| **Total assets** | | **1,565.8** | 1,709.3 |
| **EQUITY** | | | |
| Share capital | 20 | **38.1** | 38.1 |
| Share premium | 20 | **367.7** | 367.7 |
| Own shares | 22 | **(7.1)** | – |
| Other reserves | 21 | **1,282.1** | 1,357.7 |
| Accumulated deficit | | **(922.1)** | (1,013.9) |
| **Equity attributable to owners** | | **758.7** | 749.6 |
| **LIABILITIES** | | | |
| **Non-current liabilities** | | | |
| Borrowings | 23 | **392.8** | 473.2 |
| Deferred income tax liabilities | 24 | **200.9** | 269.8 |
| Derivative financial liabilities | 25 | **3.8** | 8.5 |
| Liability for share-based payments | 27 | **–** | 0.1 |
| Retirement benefit obligations | 28 | **15.8** | 14.4 |
| | | **613.3** | 766.0 |
| **Current liabilities** | | | |
| Trade and other payables | 29 | **112.2** | 122.1 |
| Current income tax liabilities | 11 | **71.4** | 50.7 |
| Borrowings | 23 | **6.2** | 18.2 |
| Derivative financial liabilities | 25 | **3.7** | 2.7 |
| Liability for share-based payments | 27 | **0.3** | – |
| | | **193.8** | 193.7 |
| **Total liabilities** | | **807.1** | 959.7 |
| **Total equity and liabilities** | | **1,565.8** | 1,709.3 |

The accompanying Notes are integral to these financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 18 February 2013. They were signed on its behalf by:

**Geoff Wild**
Chief Executive Officer

**Mike Powell**
Chief Financial Officer

# Consolidated statement of changes in equity

| | Notes | Share capital US$m | Share premium US$m | Own shares US$m | Other reserves US$m | Accumulated deficit US$m | Total equity US$m |
|---|---|---|---|---|---|---|---|
| Balance at 1 January 2011 | | 38.1 | 367.7 | – | 1,342.9 | (1,111.1) | 637.6 |
| Profit for the year | | – | – | – | – | 96.5 | 96.5 |
| Equity-settled share-based payments | 27 | – | – | – | – | 0.7 | 0.7 |
| Other comprehensive income for the year | | – | – | – | 29.3 | – | 29.3 |
| Distributions to shareholders | 12 | – | – | – | (14.5) | – | (14.5) |
| Balance at 31 December 2011 | | 38.1 | 367.7 | – | 1,357.7 | (1,013.9) | 749.6 |
| Profit for the year | | – | – | – | – | 82.9 | 82.9 |
| Consolidation of ESOP Trust | | – | – | – | – | 7.5 | 7.5 |
| Purchase of own shares | | – | – | (7.4) | – | – | (7.4) |
| Own shares vesting to employees | | – | – | 0.3 | – | (0.3) | – |
| Equity-settled share-based payments | 27 | – | – | – | – | 1.7 | 1.7 |
| Other comprehensive loss for the year | | – | – | – | (28.0) | – | (28.0) |
| Distributions to shareholders | 12 | – | – | – | (47.6) | – | (47.6) |
| **Balance at 31 December 2012** | | **38.1** | **367.7** | **(7.1)** | **1,282.1** | **(922.1)** | **758.7** |

The accompanying Notes are integral to these financial statements.

# Consolidated cash flow statement

| | Notes | Year ended 31 December 2012 US$m | Year ended 31 December 2011 US$m |
|---|---|---|---|
| **Net cash provided by operating activities** | 31 | **152.2** | 155.1 |
| **Cash flows from investing activities** | | | |
| Purchases of property, plant and equipment | | **(46.3)** | (46.3) |
| Proceeds on disposal of property, plant and equipment | | **0.5** | 0.1 |
| Purchases of intangible assets | | **(5.3)** | (3.3) |
| Interest received | | **1.0** | 0.7 |
| Acquisition of subsidiary | | **–** | (5.2) |
| Consolidation of ESOP Trust | | **7.5** | – |
| **Net cash used in investing activities** | | **(42.6)** | (54.0) |
| **Cash flows from financing activities** | | | |
| Dividends paid | | **(47.6)** | (14.5) |
| Costs of issuing shares | | **–** | (7.8) |
| Repayments of borrowings | | **(492.7)** | (64.7) |
| New bank loans raised | | **398.0** | – |
| Purchase of own shares | 20 | **(7.4)** | – |
| **Net cash used in financing activities** | | **(149.7)** | (87.0) |
| **Net (decrease)/increase in cash** | | **(40.1)** | 14.1 |
| Cash and cash equivalents at the beginning of the year | | **148.0** | 133.7 |
| Effect of foreign exchange rate changes on cash balances | | **1.7** | 0.2 |
| **Cash and cash equivalents at the end of year** | | **109.6** | 148.0 |

The accompanying Notes are integral to these financial statements.

# Notes to the consolidated financial statements

## 1. General information
AZ Electronic Materials S.A. is a public limited liability company (Société Anonyme) incorporated and domiciled in Luxembourg. The address of its registered office is 32-36, Boulevard d'Avranches, L–1160 Luxembourg.

### Company status
AZ Electronic Materials S.A. (RCS Luxembourg: B156074) was incorporated on 12 October 2010 as a public limited liability company (Société Anonyme) under the laws of the Grand Duchy of Luxembourg and has, since incorporation, been the holding company of the Group. The Company's Ordinary shares were admitted to the premium listing segment of the Official List of the UK Listing Authority and to unconditional trading on the London Stock Exchange's main market for listed securities on 3 November 2010 ("Listing").

The nature of the Group's operations and its principal activities are set out in Note 4.

## 2. Basis of preparation
The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS regulation.

The consolidated financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for the assets.

## 3. Significant accounting policies

### Adoption of new and revised accounting standards
No new or revised standards and interpretations have been adopted in the current year.

At the date of authorisation of these financial statements, the following standards and relevant interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and some of which were pending endorsement by the EU).

- IAS 19 (revised) "Employee benefits" – effective for accounting periods beginning on or after 1 January 2013. The impact of the amendment to this disclosure will result in actuarial gains and losses being recognised fully on the balance sheet with all unrecognised actuarial gains and losses being recognised in other comprehensive income as at 1 January 2013. As at 31 December 2012, the Group had US$7.1m of unrecognised actuarial losses in respect of defined benefit schemes. This is a retrospective change and therefore a restatement is required.

The adoption of the following standards in future periods is not expected to have a material impact on the financial statements of the Group:

- IFRS 9 "Financial Instruments: Classification and measurement"
- IAS 12 "Income Taxes – Limited Scope Amendment"
- IFRS 10 "Consolidated Financial Statements"
- IFRS 11 "Joint Arrangements"
- IAS 27 (amended) "Separate Financial Statements"
- IAS 28 (amended) "Investments in Associates and Joint Ventures"
- IFRS 12 "Disclosure of Interest in Other Entities"
- IAS 1 (amended) "Presentation of Items in Other Comprehensive Income"
- IFRS 13 "Fair Value Measurement"
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine"
- IFRS 1 (amended) " First-time Adoption of IFRS" – Severe Hyperinflation, Removal of Fixed Dates for First-time Adopters and Government Loans
- Annual improvements to IFRSs: 2009-2011 Cycle
- IAS 32 (amended) "Offsetting Financial Assets and Financial Liabilities"
- IFRS 7 (amended) "Disclosures – Offsetting Financial Assets and Financial Liabilities"
- IFRS 10 (amended), IFRS 12 (amended) and IAS 27 (amended) – "Investment Entities"

*Critical accounting judgements and key sources of estimation uncertainty*
In preparing the financial statements, management have used judgements and estimates which may affect the application of accounting policies and reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Management believe that while actual results may differ from these estimates, such judgements and estimates are reasonable.

The critical judgements required when preparing the Group's accounts are as follows:

- Capitalising or expensing development costs. The nature of the research performed by the Group means that technical and commercial feasibility is not assured until product development is substantially complete. In line with IAS 38 "Intangible assets" the costs are therefore classified as research and expensed, despite the significant new knowledge and potential for alternative applications for the Group's products that these activities generate for the Group.
- Determining the amount of the Group's tax charge and tax provisions. The Group operates in a number of different jurisdictions with transactions between group companies in those jurisdictions. Tax provisions are recognised when it is considered probable that there will be a future payment to a tax authority. In such cases, provision is made for the amount that is expected to be settled. This requires the application of judgement as to the ultimate outcome, which can change over time depending on facts and circumstances in each of the jurisdictions in which the Group operates. In certain cases it is necessary for the Group to make estimates regarding tax treatment for which the ultimate outcome will only be formally determined upon resolution of such matters with the relevant tax authorities. Judgement is also required in determining deferred tax assets and liabilities including the amount, timing and jurisdiction of payment or benefit. The final resolution of such items, which could take several years, may result in material profits or losses and/or cash flows in future periods.
- Determination of the carrying value of goodwill. Determining whether goodwill is impaired requires an estimate of the value in use of the cash generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. Further detail on estimates used in the value in use calculation can be found in Note 14 to the financial statements.
- Determination of the carrying value of licences and trademarks. These are intangible assets that are subject to amortisation and are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Determination of impairment or reversal of impairment in carrying value requires, as for goodwill, an estimate of the higher of the value in use or net realisable value of the cash generating units to which licences and trademarks relate. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the intangible asset and a suitable discount rate in order to calculate present value.

## Basis of Consolidation
The subsidiaries of AZ Electronic Materials S.A. are all entities over which the Group has the power to govern the financial and operating policies and owns directly or indirectly 100% of the shareholding and voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Inter-company transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

## Going concern
The Directors consider on a regular basis the position of the Company and Group as a going concern by reviewing Group budgets, cash flow forecasts and liquidity, full details are given in the Directors' report on page 51. The Directors have, at the time of approving the financial statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. The Board continues to adopt the going concern basis of accounting in preparing the financial statements.

## Business combinations
The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. Acquisition related costs are recognised in profit or loss as incurred.

If the initial accounting for a business combination is incomplete by the end of the reporting period for which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see below), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

The measurement period is the period from the date of acquisition to the date the Group obtains complete information about facts and circumstances that existed as of the acquisition date, and is subject to a maximum of one year.

# Notes to the consolidated financial statements continued

## 3. Significant accounting policies continued

### Foreign currency translation

*Functional and presentation currency*
Items included in the financial statements of each of the Group's entities are measured in the currency of the primary economic environment in which each entity operates (the "functional currency"). The consolidated financial statements are presented in US Dollars (US$), which is the presentation currency for the Group. The presentation currency is the same as the functional currency of AZ Electronic Materials S.A.

*Transactions and balances*
In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date.

Translation differences on non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined and are reported as part of the fair value gain or loss reported in the fair value reserve in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the year.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options (see below for the Group's accounting policies in respect of such derivative financial instruments).

*Group companies*
The results and financial position of all the Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates for the period unless exchange rates fluctuate significantly during that period, in which case appropriate exchange rates at the dates of transactions are used; and
- resulting exchange differences, if any, are recognised in other comprehensive income and accumulated in the Group's translation reserve. Such translation differences are reclassified to the income statement as income or expenses in the period in which the operation is disposed. Exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

### Property, plant and equipment
Land and buildings comprise mainly manufacturing plants and offices. Land is not depreciated and is shown at historical cost. All other property, plant and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial year in which they are incurred.

Assets under construction are carried at cost. Depreciation of the assets, on the same basis as other items of property, plant and equipment, commence when they are ready for use.

Land is not depreciated. Depreciation on other assets is calculated using the straight line method to allocate their cost or revalued amounts less their residual values over their estimated useful lives, as follows:

| | |
|---|---|
| • Buildings | 16 – 40 years |
| • Machinery and equipment | 6 – 16 years |
| • Furniture, vehicles, computer hardware | 3 – 10 years |

Assets under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement during the year in which they are incurred.

## Intangible assets

*Goodwill*
Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

*Trademarks and licences*
Trademarks and licences are shown at historical cost or fair value on acquisition. Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight line method to allocate the cost of trademarks and licences over their estimated useful lives up to a maximum of 15 years.

*Computer software*
Acquired computer software licences are capitalised based on the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives up to a maximum of five years.

Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

## Impairment of non-financial assets
Non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell, and value in use. In addition to this, goodwill is tested for impairment at least annually.

## Financial instruments
Financial assets and financial liabilities are recognised in the Group's balance sheet when the group becomes a party to the contractual provisions of the instrument.

*Trade receivables*
Trade receivables do not carry interest and are stated at nominal value as reduced by provisions for irrecoverable amounts. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Any movement in the amount of the provision is recognised in the income statement.

*Other investments*
Other investments classified as financial assets at fair value through profit or loss and available for sale financial assets are stated at fair value. Where equity instruments do not have a quoted market price in an active market, and whose fair value cannot be reliably measured are measured at cost. For available for sale investments, gains and losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period.

*Cash and cash equivalents*
Cash and cash equivalents includes cash in hand, deposits held on call with banks, other short term highly liquid investments with original maturities of three months or less, and bank overdrafts.

*Trade payables*
Trade payables are not interest bearing and are stated at their nominal value.

*Financial liabilities – borrowings*
Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

*Equity instruments*
Equity instruments issued by the Group are recorded at the procceds received, net of direct issuance costs.

## Derivative financial instruments
Derivatives are initially recognised at fair value on the trade date when a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge); (2) hedges of firm commitments or highly probable forecast transactions (cash flow hedges); or (3) hedges of net investments in foreign operations.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 26. Movements on the hedging reserve in shareholders' equity are shown in Note 21.

# Notes to the consolidated financial statements continued

## 3. Significant accounting policies continued

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

*Fair value hedge*
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement in finance costs (Note 10), together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

*Cash flow hedge*
The effective portions of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately as finance costs in the income statement.

Amounts previously recognised in other comprehensive income and accumulated in equity are recycled in the income statement in the periods when the hedged item will affect profit or loss (for instance when the forecast sale that is hedged takes place). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised in other comprehensive income at that time remains accumulated in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss accumulated in equity is immediately transferred to the income statement.

*Net investment hedge*
Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in other comprehensive income and accumulated in hedging reserves within equity (Note 21); the gain or loss relating to the ineffective portion is recognised immediately in the income statement in investment income (Note 9) or finance costs (Note 10) depending on the movement in exchange rates.

Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

*Derivatives that do not qualify for hedge accounting*
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

### Inventories
Inventories are calculated on a first in, first out ("FIFO") basis and are stated at the lower of cost and net realisable value. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs, and related production overheads (based on normal operating capacity), but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses and distribution costs.

### Taxation including deferred taxation
Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit not the accounting profit.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of a reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

## Employee benefits

*Post employment benefits*
For defined benefit plans, the difference between the present value of the defined benefit obligation at the balance sheet date and the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs, is recognised as an asset or liability on the balance sheet. Scheme liabilities are assessed by independent actuaries, using the projected unit funding method and applying the principal actuarial assumptions at the reporting period date. Assets are valued at fair value.

Actuarial gains and losses are not recognised in the balance sheet except where the unrecognised gains and losses exceed a corridor of 10% of the balance sheet liability. The excess over this corridor is recognised in the income statement over the average remaining working lives of the current and former employees participating in the scheme. Under revisions to IAS 19 "Post employment benefits" the corridor approach is discontinued and all actuarial gains and losses will be recognised on the balance sheet from 1 January 2013.

Past service costs are recognised immediately to the extent that the benefits are already vested, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight line basis over the vesting period.

The Group's contributions to defined contribution plans are charged to the income statement as they fall due.

*Share-based payments*
The fair value of equity-settled share options granted to employees is recognised as an expense. The fair value is measured at grant date and spread over the vesting period based on the Group's estimate of equity instruments that will eventually vest. At each balance sheet date, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market-based vesting conditions. The impact of the revision, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in Note 27.

For cash-settled share-based payments, a liability is recognised for the services acquired, measured initially at the fair value of the liability. At the balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognised in the profit or loss for the year. The fair value of the options granted is measured using the Black-Scholes model, taking into account the terms and conditions upon which the options were granted.

## Share capital – investment in own shares
Shares acquired by the employee share ownership plan ("ESOP") trust are shown as a reduction in equity. Movements in the year arising from additional purchases by the Trustees of shares or the receipt of funds due to the exercise of options by employees are accounted for within reserves and shown as a movement in equity attributable to owners of the parent in the year. Administration expenses of the trusts are charged to the income statement as incurred.

## Provisions
Provisions are recognised when the Group has a present legal or constructive obligation, as a result of past events, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle that obligation at the balance sheet date, and are discounted to present value where the effect is material.

## Revenue recognition
Revenue comprises the fair value for the sale of goods, net of value added tax, volume rebates, and discounts, royalty, interest and dividend income, and after eliminating sales within the Group. Income is recognised as follows:

*Sales of goods*
Sales of goods are recognised when a Group entity has delivered products to the customer, the customer has accepted the products and recovery of the related receivables is reasonably assured.

*Royalty income*
Royalty income is recognised on an accruals basis in accordance with the substance of the relevant agreements. Royalty income is included in other gains and losses (Note 8).

*Interest income*
Interest income is recognised on an effective interest basis for debt instruments other than those financial instruments classified as fair value through profit or loss.

*Dividend income*
Dividend income is recognised when the right to receive payment is established.

# Notes to the consolidated financial statements continued

## 3. Significant accounting policies continued

### Research and development costs
Research is original and planned investigation to acquire new scientific or technical knowledge and understanding and is charged to the income statement when incurred.

Research costs include:

- Personnel costs of people in research departments/centres;
- Cost of materials and services used in research activities;
- Depreciation of equipment used in research;
- Laboratory costs;
- Outside services from third parties; and
- Overheads and other costs associated with research function.

Development is applying the research findings to a plan or design for the production of new materials, products or services before commercial use/production.

In judging whether development costs are capitalised as intangible assets or charged to the income statement, management consider whether the strict recognition criteria as set out in IAS 38 “Intangible Assets” have been met at the time the costs are incurred. The nature of the research performed by the Group means that technical and commercial feasibility is not assured until product development is substantially complete. In line with IAS 38, the costs are therefore classified as research and expensed, despite the significant new knowledge and potential for alternative applications for the Group’s products that these activities generate for the Group.

### Leases
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

### Dividends paid
The interim dividend is included in the financial statements in the period it is approved by the Directors, and the final dividend in the period it is approved by shareholders at the Annual General Meeting.

## 4. Segment information
The Group has identified its reportable segments, recognising the different characteristics of those segments as reflected in the information provided to the members of the Global Management Team (“GMT”) that is responsible for the day-to-day management of the Group. The GMT comprises the Chief Executive Officer, Chief Financial Officer, Chief Technology Officer, the heads of the Business Divisions, Group Operations, HR and R&D.

The Group is focused on the ultimate end use of the products manufactured and has determined that the appropriate reportable segments are as follows:

**IC Materials:** being high-purity, advanced technology products for use in integrated circuits and devices, comprising:

- IC Niche products, being a number of specialty materials, specifically spin-on dielectrics, colloidal silica CMP slurries and lithographic process material that facilitate yield and pattern enhancements; and
- IC Conventional products constituting more widely available, and generally older products for photolithographic processes, specifically photoresists including thick film resists, edge bead removers (“EBRs”) and other ancillary products.

**Optronics:** being products used in the production of flat panel displays (“FPDs”) for use in televisions, computer monitors and similar equipment, comprising:

- FPD Photoresist products, being light-sensitive processing materials for FPDs; and
- Optronics Other products, including EBRs, other ancillaries and silicon chemistry-based products for the Light & Energy business (serving displays, lighting and other non-electronic markets).

**Printing and Other:** being mainly printing and similar products used in photo lithographic processes.

**Corporate:** being staff and running costs of corporate and support services offices.

The accounting policies of the reportable segments are the same as the Group’s accounting policies described in Note 3.

The GMT uses EBITDA to measure the profitability of each segment. EBITDA represents operating profit excluding amortisation of intangible assets and depreciation in order to provide management with a consistent comparison of the Group’s businesses, on a year-on-year basis and with other businesses.

Information regarding the Group's reporting segments is reported as follows:

## Segment revenues

The following is an analysis of the Group's revenue generated from external customers by reportable segment:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| IC Materials | **537.2** | 545.1 |
| Optronics | **236.9** | 224.1 |
| Printing and Other | **19.8** | 22.6 |
| **Total revenue** | **793.9** | 791.8 |

All the revenue is derived from the sale of goods and is from continuing operations. There are no inter-segment sales.

Below is a breakdown of total sales revenue by product type:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| IC Niche | **356.0** | 352.1 |
| IC Conventional | **181.2** | 193.0 |
| **Total IC Materials revenue** | **537.2** | 545.1 |
| FPD Photoresist | **188.0** | 177.2 |
| Optronics Other | **48.9** | 46.9 |
| **Total Optronics revenue** | **236.9** | 224.1 |
| **Total Printing and Other revenue** | **19.8** | 22.6 |
| **Total revenue** | **793.9** | 791.8 |

## Segment results

The following is an analysis of the Group's EBITDA by reportable segment:

| **Year ended 31 December 2012 (US$m)** | **IC Materials** | **Optronics** | **Printing and Other** | **Corporate** | **Total** |
|---|---|---|---|---|---|
| **EBITDA** | **215.8** | **67.9** | **2.0** | **(23.3)** | **262.4** |
| Depreciation | **(20.1)** | **(8.4)** | **(0.6)** | **–** | **(29.1)** |
| EBITA | **195.7** | **59.5** | **1.4** | **(23.3)** | **233.3** |
| Amortisation of intangible assets | **(56.6)** | **(24.7)** | **(1.3)** | **–** | **(82.6)** |
| **Operating profit/(loss)** | **139.1** | **34.8** | **0.1** | **(23.3)** | **150.7** |
| Net investment income and finance costs | | | | | **(21.6)** |
| Profit before tax | | | | | **129.1** |
| Tax | | | | | **(46.2)** |
| Profit after tax | | | | | **82.9** |

| Year ended 31 December 2011 (US$m) | IC Materials | Optronics | Printing and Other | Corporate | Total |
|---|---|---|---|---|---|
| EBITDA | 219.2 | 62.8 | (0.8) | (20.2) | 261.0 |
| Depreciation | (18.4) | (8.4) | (1.2) | – | (28.0) |
| EBITA | 200.8 | 54.4 | (2.0) | (20.2) | 233.0 |
| Amortisation of intangible assets | (55.7) | (25.3) | (1.3) | – | (82.3) |
| Operating profit/(loss) | 145.1 | 29.1 | (3.3) | (20.2) | 150.7 |
| Net investment income and finance costs | | | | | (25.1) |
| Profit before tax | | | | | 125.6 |
| Tax | | | | | (29.1) |
| Profit after tax | | | | | 96.5 |

# Notes to the consolidated financial statements continued

## 4. Segment information continued

### Segment assets and liabilities

| 31 December 2012 (US$m) | IC Materials | Optronics | Printing and Other | Corporate | Total |
|---|---|---|---|---|---|
| Assets | **1,112.1** | **304.8** | **14.0** | **134.9** | **1,565.8** |
| Liabilities | **(70.4)** | **(40.3)** | **(1.5)** | **(694.9)** | **(807.1)** |
| **Total assets and liabilities** | **1,041.7** | **264.5** | **12.5** | **(560.0)** | **758.7** |

| 31 December 2011 (US$m) | IC Materials | Optronics | Printing and Other | Corporate | Total |
|---|---|---|---|---|---|
| Assets | 1,187.4 | 337.3 | 15.4 | 169.2 | 1,709.3 |
| Liabilities | (82.5) | (37.6) | (2.0) | (837.6) | (959.7) |
| Total assets and liabilities | 1,104.9 | 299.7 | 13.4 | (668.4) | 749.6 |

Corporate assets and liabilities include cash, certain financial assets and liabilities, tax and other non-current assets and liabilities which are reviewed and controlled centrally. Corporate assets and liabilities not controlled centrally are allocated in proportion to the Group revenue contributed by that segment.

### Other segment information

| Year ended 31 December 2012 (US$m) | IC Materials | Optronics | Printing and Other | Total |
|---|---|---|---|---|
| Additions to tangible fixed assets | **37.8** | **8.0** | **0.2** | **46.0** |
| Additions to intangible fixed assets | **3.5** | **1.1** | **0.1** | **4.7** |
| **Total fixed asset additions** | **41.3** | **9.1** | **0.3** | **50.7** |
| **Research and development expenditure** | **43.4** | **11.6** | **0.8** | **55.8** |

| Year ended 31 December 2011 (US$m) | IC Materials | Optronics | Printing and Other | Total |
|---|---|---|---|---|
| Additions to tangible fixed assets | 35.0 | 9.3 | 1.2 | 45.5 |
| Additions to intangible fixed assets | 3.5 | 1.5 | – | 5.0 |
| Total fixed asset additions | 38.5 | 10.8 | 1.2 | 50.5 |
| Research and development expenditure | 41.0 | 10.6 | 2.4 | 54.0 |

From 1 January 2013, in line with changes in the management structure of the Group, the Printing and Other segment will be included within the IC Materials reportable segment.

### Geographic information

The Group's revenue from external customers by geographic area of the Group's selling locations is as follows:

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| Taiwan | **211.9** | 209.1 |
| South Korea | **187.1** | 186.4 |
| Japan | **133.0** | 141.5 |
| China | **63.6** | 64.2 |
| Singapore | **36.0** | 34.0 |
| India | **1.0** | 0.2 |
| **Total Asia** | **632.6** | 635.4 |
| Germany | **50.2** | 52.6 |
| France | **13.6** | 14.7 |
| **Total Europe** | **63.8** | 67.3 |
| USA | **97.5** | 89.1 |
| **Total USA** | **97.5** | 89.1 |
| **Total revenue** | **793.9** | 791.8 |

The Group's non-current assets other than financial instruments and deferred tax assets by geographic area are as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Japan | **499.9** | 614.3 |
| Taiwan | **122.7** | 115.2 |
| South Korea | **104.5** | 80.9 |
| China | **40.1** | 40.9 |
| Singapore | **20.3** | 21.6 |
| India | **1.2** | 1.0 |
| **Total Asia** | **788.7** | 873.9 |
| France | **52.3** | 57.2 |
| Germany | **52.1** | 51.9 |
| Luxembourg | **7.2** | 7.9 |
| UK | **5.4** | 3.5 |
| **Total Europe** | **117.0** | 120.5 |
| USA | **292.8** | 315.1 |
| **Total USA** | **292.8** | 315.1 |
| **Total non-current assets** | **1,198.5** | 1,309.5 |

## Information about major customers

Revenues from one customer of the Group's IC Materials and Optronics segments represent US$154.4m, 19% (2011: US$141.1m, 18%) of the Group's total revenues for the year. No other single customer amounted to more than 10% of the Group's total revenue.

## 5. Profit before tax

Profit before tax for the year has been arrived at after charging/(crediting):

| | Notes | 2012 US$m | 2011 US$m |
|---|---|---|---|
| Cost of inventory sold | | **287.2** | 281.4 |
| Employee benefits expense | 7 | **108.8** | 107.9 |
| Research & development costs | | **55.8** | 54.0 |
| Depreciation of property, plant and equipment | 16 | **29.1** | 28.0 |
| (Gain)/loss on disposal of property, plant and equipment | | **(0.1)** | 0.4 |
| Amortisation of intangible assets | 15 | **82.6** | 82.3 |
| Write downs of inventories recognised as an expense | | **1.8** | 0.1 |
| Reversal of inventory write downs no longer required | | **(0.6)** | – |
| Impairment losses on trade receivables recognised | 19 | **1.2** | 0.1 |
| Impairment losses on trade receivables reversed | 19 | **(1.3)** | (0.5) |
| Foreign exchange losses – net | | **1.8** | 3.2 |

## 6. Auditor's remuneration

The analysis of auditor's remuneration is as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Fees payable to the Company's auditor and their associates for the audit of the Company's annual report** | **0.2** | 0.2 |
| **Fees payable to the Company's auditor and their associates for services to the Group** | | |
| – The audit of the Company's subsidiaries | **0.6** | 0.7 |
| **Total audit fees** | **0.8** | 0.9 |
| Audit-related assurance services | **0.1** | 0.1 |
| Other taxation advisory services | **0.5** | 1.3 |
| **Total non-audit fees** | **0.6** | 1.4 |

# Notes to the consolidated financial statements continued

## 7. Employee benefits expense

As at 31 December 2012, the number of employees was 1,092 (2011: 1,060).

The average number of employees was:

| | 2012 | 2011 |
|---|---|---|
| Production, research and development | **759** | 735 |
| Selling and marketing | **135** | 134 |
| Administration | **175** | 157 |
| **Total** | **1,069** | 1,026 |

Their aggregate remuneration comprised:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Wages and salaries | **90.9** | 90.8 |
| Social security costs | **12.3** | 11.7 |
| Redundancy costs | **0.5** | 0.9 |
| Retirement benefits – defined contribution plans | **3.4** | 3.3 |
| Retirement benefits – defined benefit plans (Note 28)* | **1.7** | 1.2 |
| **Total** | **108.8** | 107.9 |

*There are additional defined benefit retirement costs included in finance costs. See Note 28 for further details.

## 8. Operating costs

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Selling and marketing costs: | | |
| Amortisation of licences and trademarks | **81.8** | 81.8 |
| Other expenses | **21.2** | 26.0 |
| Total selling and marketing costs | **103.0** | 107.8 |
| Research and development costs | **55.8** | 54.0 |
| Distribution costs | **8.5** | 7.6 |
| Administrative costs | **58.7** | 53.8 |
| Other gains and losses | **(2.9)** | (3.3) |
| **Total** | **223.1** | 219.9 |

## 9. Investment income

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Interest income – bank | **1.0** | 0.7 |
| Financial asset valuation adjustment – investments | **0.7** | 0.9 |
| | **1.7** | 1.6 |

Investment income earned on financial assets analysed by category of asset is as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Investments at fair value through profit or loss | **0.7** | 0.9 |
| Loans and receivables (principally cash and bank balances) | **1.0** | 0.7 |
| **Investment income earned on financial assets** | **1.7** | 1.6 |

## 10. Finance costs

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Interest on bank overdraft and loans | **13.6** | 15.5 |
| Retirement benefits | **0.8** | 0.8 |
| Fair value losses on interest rate swaps transferred from equity for cash flow hedges of floating rate debt | **6.4** | 10.8 |
| Exchange differences (ineffective net investment hedge) | **2.1** | (0.6) |
| Losses on derivatives designated at fair value through profit or loss: | | |
| – Interest rate derivatives | **0.4** | 0.2 |
| **Total finance costs** | **23.3** | 26.7 |

## 11. Tax

The amounts recognised in the income statement were as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Current tax | **79.1** | 65.3 |
| Withholding taxes – current | **3.8** | 6.0 |
| **Total current tax charge** | **82.9** | 71.3 |
| Deferred tax | **(26.4)** | (35.1) |
| Withholding taxes – deferred | **(10.3)** | (7.1) |
| **Total deferred tax credit (Note 24)** | **(36.7)** | (42.2) |
| **Total tax** | **46.2** | 29.1 |

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to the results of the consolidated companies as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Profit before tax | **129.1** | 125.6 |
| Tax calculated at domestic tax rates applicable to profits in the respective countries* | **34.5** | 38.3 |
| Permanent differences | **4.5** | (0.5) |
| Tax losses and other temporary timing differences for which no deferred income tax asset is recognised | **13.5** | 11.0 |
| Tax credits | **(0.3)** | (3.6) |
| Withholding and other taxes | **(6.5)** | (1.1) |
| Changes in statutory tax rates | **0.5** | (14.9) |
| Prior period tax adjustments | **–** | (0.1) |
| **Tax charge** | **46.2** | 29.1 |
| ***Weighted average applicable statutory tax rate** | **26.7%** | 30.5% |

In addition to the amount charged to the income statement, the following amounts relating to tax have been recognised in other comprehensive income:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Current tax** | | |
| Translation of foreign operations | **24.0** | 0.5 |
| | **24.0** | 0.5 |
| **Deferred tax** | | |
| Arising on income and expenses recognised in other comprehensive income: | | |
| Translation of foreign operations | **(22.5)** | 0.5 |
| | **(22.5)** | 0.5 |
| Total income tax charge recognised in other comprehensive income | **1.5** | 1.0 |

# Notes to the consolidated financial statements continued

## 11. Tax continued

Movement in the net current tax liability recognised in the balance sheet:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Net current tax creditor** | | |
| **Opening balance** | **48.9** | 51.3 |
| Income statement charge | **82.9** | 71.3 |
| Tax charged to other comprehensive income | **24.0** | 0.5 |
| Tax paid | **(84.9)** | (75.3) |
| Exchange differences | **(2.0)** | 1.1 |
| **Closing balance** | **68.9** | 48.9 |
| **Comprising:** | | |
| Current income tax assets | **2.5** | 1.8 |
| Current income tax liabilities | **(71.4)** | (50.7) |

## 12. Dividends

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Amounts recognised as distributions to equity holders in the year:** | | |
| Interim dividend for the year ended 31 December 2012 of 4.0 cents (2011: 3.8 cents) per Ordinary share | **15.2** | 14.5 |
| Proposed final dividend for the year ended 31 December 2012 of 9.1 cents (2011: 8.5 cents) per Ordinary share | **34.5** | 32.4 |

The proposed final dividend is subject to approval by the shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

## 13. Earnings per share

The calculation of basic earnings per share has been based on the profit for the year and the number of shares for the relevant years set out below.

| | 2012 | 2011 |
|---|---|---|
| Profit attributed to shareholders (US$m) | **82.9** | 96.5 |
| Weighted average number of shares for the purposes of basic earnings per share | **380,681,383** | 380,913,552 |
| **Basic earnings per share (cents)** | **21.8** | 25.3 |
| Effect of dilutive potential Ordinary shares | | |
| – share options | **1,027,746** | 39,131 |
| Weighted average number of Ordinary shares for the purposes of diluted earnings per share | **381,709,129** | 380,952,683 |
| **Diluted earnings per share (cents)** | **21.7** | 25.3 |

During the year, AZ Ordinary shares have been purchased by the ESOP trust which have been excluded in determining the weighted average number of shares for the purpose of calculating basic and diluted earnings per share.

In the calculation of adjusted earnings per share, the profit attributable to shareholders has been adjusted for amortisation of intangible assets net of the related deferred tax. In the prior year, the add back for amortisation of intangible assets net of the related deferred tax includes a US$13.1m reduction principally to eliminate the impact of the change in corporate tax rate in Japan.

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Profit after tax from continuing operations | **82.9** | 96.5 |
| Add back (net of tax): | | |
| amortisation of intangible assets | **51.8** | 37.6 |
| Adjusted profit after tax from continuing operations | **134.7** | 134.1 |
| Weighted average number of shares | **380,681,383** | 380,913,552 |
| **Adjusted basic earnings per share (cents)** | **35.4** | 35.2 |

## 14. Goodwill

| Cost and net book value | 2012 US$m | 2011 US$m |
|---|---|---|
| At start of the year | **413.4** | 410.0 |
| Exchange differences | **(4.4)** | 3.4 |
| **At end of the year** | **409.0** | 413.4 |

Goodwill is allocated to each of the Group's cash-generating units (CGUs) that are expected to benefit from the synergies of business combinations. These have been identified as:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| IC Materials | **347.2** | 352.6 |
| Optronics | **61.8** | 60.8 |
| **Total** | **409.0** | 413.4 |

### Impairment tests for goodwill

The recoverable amount of a CGU, or group of CGUs, has been determined based on value in use calculations. These calculations use cash flow projections based on the financial budget for the coming year and on the three year outlook approved by management. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and gross margin. These assumptions have been revised in the year in light of the current economic environment and the current outlook for markets in which the Group operates. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecast. Management determined budgeted gross margin based on past performance and its expectations for the market development.

Cash flows beyond the three year period are extrapolated using an estimated growth rate of 2% (2011: 2%). This rate does not exceed the long-term average growth rate for the markets in which the CGUs operate.

The pre-tax rate used to discount the forecast cash flows for both IC Materials and Optronics is 12.2% (2011: 12.0%) as the Directors have determined that both groups of CGUs are exposed to similar risks.

The Directors have tested the carrying value of goodwill under the impairment assumptions above and conclude that no impairment was required during the year (2011: US$nil).

Management have performed a sensitivity review on the impairment test of each CGUs carrying value. The Directors believe that there are no assumptions for which reasonably possible changes would give rise to an impairment of goodwill.

## 15. Intangible assets

| | Licences and trademarks US$m | Computer software US$m | Total US$m |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2011 | 1,018.1 | 14.0 | 1,032.1 |
| Exchange differences | 25.5 | – | 25.5 |
| Additions | 2.2 | 2.8 | 5.0 |
| Acquired on acquisition | 3.3 | – | 3.3 |
| At 31 December 2011 | 1,049.1 | 16.8 | 1,065.9 |
| Exchange differences | (47.0) | – | (47.0) |
| Additions | 1.8 | 2.9 | 4.7 |
| **At 31 December 2012** | **1,003.9** | **19.7** | **1,023.6** |
| **Accumulated amortisation** | | | |
| At 1 January 2011 | (297.8) | (13.3) | (311.1) |
| Exchange differences | (7.0) | – | (7.0) |
| Amortisation charge for the year | (81.8) | (0.5) | (82.3) |
| At 31 December 2011 | (386.6) | (13.8) | (400.4) |
| Exchange differences | 10.1 | – | 10.1 |
| Amortisation charge for the year | (81.8) | (0.8) | (82.6) |
| **At 31 December 2012** | **(458.3)** | **(14.6)** | **(472.9)** |
| **Carrying Value** | | | |
| **At 31 December 2012** | **545.6** | **5.1** | **550.7** |
| At 31 December 2011 | 662.5 | 3.0 | 665.5 |
| At 1 January 2011 | 720.3 | 0.7 | 721.0 |

# Notes to the consolidated financial statements continued

## 16. Property, plant and equipment

| | Land and buildings US$m | Machinery and equipment US$m | Furniture, vehicles, computer hardware US$m | Assets under construction US$m | Total US$m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2011 | 124.0 | 125.0 | 13.6 | 20.7 | 283.3 |
| Exchange differences | 3.6 | 1.7 | (0.5) | (0.6) | 4.2 |
| Additions | – | – | – | 45.5 | 45.5 |
| Disposals | – | (0.5) | – | – | (0.5) |
| Transfers on completion | 12.2 | 36.1 | 7.1 | (55.4) | – |
| Acquired on acquisition | 0.4 | 0.6 | 0.2 | 0.1 | 1.3 |
| At 31 December 2011 | 140.2 | 162.9 | 20.4 | 10.3 | 333.8 |
| Exchange differences | (7.0) | (6.1) | 1.0 | 0.9 | (11.2) |
| Additions | – | – | – | 46.0 | 46.0 |
| Disposals | – | – | (0.6) | – | (0.6) |
| Transfers on completion | 3.4 | 16.2 | 1.6 | (21.2) | – |
| **At 31 December 2012** | **136.6** | **173.0** | **22.4** | **36.0** | **368.0** |
| **Accumulated depreciation** | | | | | |
| At 1 January 2011 | (19.8) | (55.2) | (6.7) | – | (81.7) |
| Exchange differences | (0.5) | 0.2 | 0.4 | – | 0.1 |
| Charge for the year | (6.8) | (18.1) | (3.1) | – | (28.0) |
| At 31 December 2011 | (27.1) | (73.1) | (9.4) | – | (109.6) |
| Exchange differences | 1.3 | 2.4 | (0.8) | – | 2.9 |
| Disposals | – | – | 0.2 | – | 0.2 |
| Charge for the year | (6.2) | (19.7) | (3.2) | – | (29.1) |
| **At 31 December 2012** | **(32.0)** | **(90.4)** | **(13.2)** | **–** | **(135.6)** |
| **Net Book Value** | | | | | |
| **At 31 December 2012** | **104.6** | **82.6** | **9.2** | **36.0** | **232.4** |
| At 31 December 2011 | 113.1 | 89.8 | 11.0 | 10.3 | 224.2 |
| At 1 January 2011 | 104.2 | 69.8 | 6.9 | 20.7 | 201.6 |

There were no bank borrowings secured on land and buildings at the year-end (2011: US$nil).

At the year-end, the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to US$6.8m (2011: US$8.4m).

## 17. Investments

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| **Investments at fair value through profit or loss:** | | |
| Sub-participation interests | **0.8** | 0.9 |
| **Available for sale investments:** | | |
| Investments | **5.2** | 5.1 |
| **Held to maturity investments:** | | |
| Land use rights | **0.4** | 0.4 |
| **Total** | **6.4** | 6.4 |

### Investments at fair value through profit or loss

*Sub-participation interests*
The Group holds a 5.5% sub-participation in Infraserv, a limited partnership registered in Germany, which provides office space and site infrastructure services to the Group's German subsidiary. The Group is entitled to voting rights but no rights to any residual value relating to the investment. The sub-participation is carried at its fair value, which has been estimated using a valuation technique based on the expected future cash flows discounted at a rate of 9% (2011: 9%). The discount rate applied reflects the local entity's weighted average cost of capital.

### Investments – available for sale

*Investments*
The investment held by the Group represents a further 15% equity holding in Infraserv. As this investment does not have a quoted market price in an active market and fair value cannot be reliably measured this investment is measured at cost.

### Investments – held to maturity

*Land use rights*
Land use rights represent amounts paid to the regulatory authorities in China in return for the use of certain land for a specific period. The asset is amortised over the length of the period for which the use has been granted, in this case 50 years.

## 18. Inventory

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Raw materials | **16.0** | 13.7 |
| Work in progress | **19.3** | 20.0 |
| Finished goods | **41.7** | 45.8 |
| **Total** | **77.0** | 79.5 |

## 19. Financial assets

### Trade and other receivables

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Trade receivables | **142.5** | 137.3 |
| Less: provisions for bad debts | **(1.1)** | (2.2) |
| **Trade receivables – net** | **141.4** | 135.1 |
| Other receivables | **13.9** | 16.1 |
| Prepayments | **6.5** | 6.3 |
| **Total** | **161.8** | 157.5 |

There are no amounts considered past due except where detailed below.

The average credit period taken on sales, as at the year-end, is 59 days (2011: 57 days), reflecting the high level of sales in Japan where longer credit terms are standard practice.

Credit risk is concentrated mainly within the Group's top 20 debtors who are considered to be blue chip and account for over 50% of outstanding debt at each balance sheet date.

Credit limits are reviewed on a twice yearly basis and following any significant changes in the level of sales with a customer.

The Directors consider that the carrying amount of trade and other receivables approximates their fair value.

### Bad debt provision

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **At start of the year** | **(2.2)** | (4.0) |
| Impairment losses recognised | **(1.2)** | (0.1) |
| Amounts written off as uncollectible | **1.1** | 1.4 |
| Impairment losses reversed | **1.3** | 0.5 |
| Exchange differences | **(0.1)** | – |
| **At end of the year** | **(1.1)** | (2.2) |

Bad debt provisions are made for all receivables that are overdue more than 60 days or are in a form of bankruptcy procedure. At the year-end there were no debts greater than 60 days overdue, or in a form of bankruptcy procedure, which were not provided for.

In determining the recoverability of a trade receivable, the Group considers any change in credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The Directors believe that there is no further credit provision required in excess of the bad debt provision.

# Notes to the consolidated financial statements continued

## 19. Financial assets continued

### Ageing of trade receivables

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Days past due** | | |
| Not yet due | **134.8** | 129.5 |
| 0 – 30 days | **6.3** | 5.0 |
| 31 – 60 days | **0.3** | 0.6 |
| 61 – 90 days | **0.2** | 0.1 |
| 91+ days | **0.9** | 2.1 |
| **Total** | **142.5** | 137.3 |

### Ageing of past due impaired trade receivables

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Days past due** | | |
| 61 – 90 days | **0.2** | 0.1 |
| 91+ days | **0.9** | 2.1 |
| **Total** | **1.1** | 2.2 |

### Ageing of past due non-impaired trade receivables

The Group has not provided for the amounts below as there has not been a significant change in credit quality and the amounts are considered recoverable.

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Days past due** | | |
| 0 – 30 days | **6.3** | 5.0 |
| 31 – 60 days | **0.3** | 0.6 |
| **Total** | **6.6** | 5.6 |

The average overdue age of these receivables was 16 days (2011: 18 days) past due date.

### Cash and cash equivalents

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Cash at bank and in hand** | **109.6** | 148.0 |

Cash and cash equivalents comprise cash held by the Group and short term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

The average interest rates on short term bank deposits was 0.5% (2011: 0.3%).

## 20. Issued equity

| | No. of shares | Share capital US$m | Share premium US$m | Total equity issued US$m |
|---|---|---|---|---|
| **Ordinary Shares** | | | | |
| As at 31 December 2011 | 380,913,552 | 38.1 | 367.7 | 405.8 |
| **As at 1 January and 31 December 2012** | **380,913,552** | **38.1** | **367.7** | **405.8** |

The total number of authorised Ordinary shares is 920,000,000 shares with a par value of US$0.10 per share. All shares rank equally on liquidation.

During the year, the Company, through an ESOP Trust, purchased 1,325,441 shares in the open market. The total amount paid to acquire the shares was US$7.4m. The shares are held as "own shares".

During the year, 56,327 shares vested as part of a restricted stock award with nil consideration. These were satisfied with shares transferred from the Group's ESOP Trust.

Share premium is a distributable reserve under Luxembourg law. The Group share premium varies from the Company share premium due to the costs of raising equity of US$22.3m which are not permitted to be set off against share premium under Luxembourg GAAP.

## 21. Other reserves

| | Capital reduction reserve US$m | Merger reserve US$m | Hedging reserves US$m | Translation reserves US$m | Total other reserves US$m |
|---|---|---|---|---|---|
| At 1 January 2011 | 1,222.4 | (6.9) | (19.3) | 146.7 | 1,342.9 |
| Gains/(loss) recognised on: | | | | | |
| – Interest rate swaps | – | – | (3.9) | – | (3.9) |
| – Forward foreign exchange contracts | – | – | 0.9 | – | 0.9 |
| Transfer to income: | | | | | |
| – Interest rate swaps | – | – | 10.8 | – | 10.8 |
| – Forward foreign exchange contracts | – | – | 1.0 | – | 1.0 |
| Exchange differences on translation of overseas operations | – | – | – | 21.5 | 21.5 |
| Related income tax | – | – | – | (1.0) | (1.0) |
| Distributions to shareholders | (14.5) | – | – | – | (14.5) |
| At 31 December 2011 | 1,207.9 | (6.9) | (10.5) | 167.2 | 1,357.7 |
| Loss recognised on: | | | | | |
| – Interest rate swaps | – | – | (1.1) | – | (1.1) |
| – Forward foreign exchange contracts | – | – | (1.6) | – | (1.6) |
| Transfer to income: | | | | | |
| – Interest rate swaps | – | – | 6.4 | – | 6.4 |
| – Forward foreign exchange contracts | – | – | (0.7) | – | (0.7) |
| Exchange differences on translation of overseas operations | – | – | – | (29.5) | (29.5) |
| Related income tax | – | – | – | (1.5) | (1.5) |
| Distributions to shareholders | (47.6) | – | – | – | (47.6) |
| **At 31 December 2012** | **1,160.3** | **(6.9)** | **(7.5)** | **136.2** | **1,282.1** |

On 12 October 2010, the Group's shareholders resolved to effect a reduction in the share capital of the Group by crediting a distributable reserve (the "Capital reduction reserve"). The Group is able to utilise such Capital reduction reserve to pay distributions to shareholders.

The merger reserve relates to the purchase of Ridgefield Holdco on 27 October 2010. The merger reserve represents the difference between the nominal value of the share capital and the fair value of the share capital of Ridgefield Holdco as at the date of acquisition.

The hedging reserves are used to hold gains and losses on the valuation of derivative instruments, which have been designated as a hedge, to match against the profit or loss or cash flow effect of the hedged item.

The translation reserves relate to foreign exchange differences on the consolidation of subsidiaries and the retranslation of monetary items forming part of net investments in foreign operations. The hedging reserves and the translation reserves are not distributable.

## 22. Own shares

Investments in own shares represent shares held by the Company's ESOP Trust which it purchased in the open market to satisfy the future vesting of shares under the Group's share incentive plans. As at 31 December 2012, the ESOP Trust held 1,269,114 shares (2011: nil) at a cost of US$7.1m (2011: US$nil) with a market value of US$7.2m (2011: US$nil).

# Notes to the consolidated financial statements continued

## 23. Financial liabilities – borrowings

During the year, the Group completed the refinancing of the entire debt facility with new facilities comprising both amortising term debt and a revolving credit facility. Of the refinancing fees incurred in arranging the new facilities, US$5.5m has been offset against the bank loans and is being amortised over the expected life of the loans, and a further US$1.5m is included in prepayments.

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Non-current** | | |
| Bank loans | **392.8** | 473.2 |
| **Total** | **392.8** | 473.2 |
| **Current** | | |
| Bank loans | **6.2** | 18.2 |
| **Total** | **6.2** | 18.2 |
| **Total borrowings** | **399.0** | 491.4 |

The maturity of non-current borrowings is as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| In the second year | **20.9** | 22.5 |
| In the third to fifth years inclusive | **371.9** | 450.7 |
| **Total** | **392.8** | 473.2 |

The carrying amounts of the Group's borrowings are denominated in the following currencies:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Bank loans** | | |
| Euro | **58.7** | 70.7 |
| United States Dollar | **340.3** | 420.7 |
| **Total** | **399.0** | 491.4 |

The weighted average interest rates charged to the income statement were as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Bank loans** | | |
| Euro | **2.59%** | 3.16% |
| United States Dollar | **2.31%** | 2.15% |

The Directors estimate the fair value of the Group's borrowings as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Fair value** | | |
| Bank loans | **404.4** | 494.1 |
| **Total** | **404.4** | 494.1 |

This fair valuation includes accrued interest of US$0.1m (2011: US$0.9m) which is recorded in other creditors in the Group's balance sheet. For debt at floating interest rates, the Directors consider that book value equates to fair value.

The Group had the following undrawn committed borrowing facilities in respect of which all conditions precedent had been met:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Floating rate – expiring beyond one year | **95.0** | 50.9 |

### Guarantees

The borrowings are secured by guarantees granted by certain material Group companies. Guarantor tests apply whereby these group of companies must represent aggregate EBITDA and gross assets, which are greater than 80% of the total Group.

As is usual practice, the Bank loans are subject to covenants comparing EBITDA to net debt and interest costs.

## 24. Deferred income tax

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| Deferred tax asset | **16.3** | 12.3 |
| Deferred tax liability | **(200.9)** | (269.8) |
| | **(184.6)** | (257.5) |

The gross movement on deferred income tax account is as follows:

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| At start of the year | **(257.5)** | (290.9) |
| Income statement credit (Note 11) | **36.7** | 42.2 |
| Tax credited/(charged) to other comprehensive income (Note 11) | **22.5** | (0.5) |
| Exchange differences | **13.7** | (8.3) |
| **At end of the year** | **(184.6)** | (257.5) |

The movement in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

| | Other temporary differences US$m | Fair value adjustment US$m | Tax on undistributed earnings US$m | Total US$m |
|---|---|---|---|---|
| **Deferred tax liabilities:** | | | | |
| At 1 January 2011 | (33.6) | (263.3) | (24.4) | (321.3) |
| (Charge)/credit to income statement | (0.5) | 40.2 | 7.1 | 46.8 |
| Charge to other comprehensive income | (0.5) | – | – | (0.5) |
| Exchange differences | (1.2) | (7.2) | – | (8.4) |
| At 31 December 2011 | (35.8) | (230.3) | (17.3) | (283.4) |
| (Charge)/credit to income statement | (2.9) | 26.8 | 10.3 | 34.2 |
| Credit to other comprehensive income | 22.5 | – | – | 22.5 |
| Exchange differences | 5.0 | 13.1 | – | 18.1 |
| **At 31 December 2012** | **(11.2)** | **(190.4)** | **(7.0)** | **(208.6)** |

| | Other temporary differences US$m | Fair value adjustment US$m | Tax losses US$m | Total US$m |
|---|---|---|---|---|
| **Deferred tax assets:** | | | | |
| At 1 January 2011 | 22.3 | 5.5 | 2.6 | 30.4 |
| Charge to income statement | (1.0) | (1.4) | (2.2) | (4.6) |
| Exchange differences | 0.1 | – | – | 0.1 |
| At 31 December 2011 | 21.4 | 4.1 | 0.4 | 25.9 |
| Credit/(charge) to income statement | 4.1 | (1.4) | (0.2) | 2.5 |
| Exchange differences | (4.5) | 0.1 | – | (4.4) |
| **At 31 December 2012** | **21.0** | **2.8** | **0.2** | **24.0** |

At the balance sheet date, the Group has unused losses of US$300.6m (2011: US$261.1m) available for offset against future profits. A deferred tax asset has been recognised in respect of US$1.9m (2011: US$3.6m) of such losses. No deferred tax asset has been recognised in respect of the remaining US$298.7m (2011: US$257.5m) as it is not considered probable that there will be future taxable profits available in the same jurisdiction as the losses. Unrecognised tax losses of US$298.7m will be carried forward; of these, US$298.6m will be carried forward indefinitely and US$0.1m will expire in 2019 (2011: US$257.5m carried forward indefinitely).

Deferred income tax liabilities of US$7.0m (2011: US$17.3m) have been recognised for the withholding tax that would be payable on all unremitted earnings as it is considered probable that all such profits will be distributed in the foreseeable future.

# Notes to the consolidated financial statements continued

## 25. Derivative financial instruments

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Assets** | | |
| **Derivatives designated and effective as hedging instruments carried at fair value** | | |
| Foreign exchange forward contracts | **–** | 0.7 |
| **Financial assets carried at fair value through profit or loss** | | |
| Interest rate cap | **0.1** | – |
| **Total** | **0.1** | 0.7 |
| **Liabilities** | | |
| **Derivatives designated and effective as hedging instruments carried at fair value** | | |
| Foreign exchange forward contracts | **(1.6)** | – |
| Interest rate swaps | **(5.9)** | (11.2) |
| **Total** | **(7.5)** | (11.2) |

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Assets** | | |
| Non-current | **0.1** | – |
| Current | **–** | 0.7 |
| **Total** | **0.1** | 0.7 |
| **Liabilities** | | |
| Non-current | **(3.8)** | (8.5) |
| Current | **(3.7)** | (2.7) |
| **Total** | **(7.5)** | (11.2) |

## 26. Financial instruments

### Categories of financial instruments

The categories of financial instruments held by the Group are as shown below. The Directors consider that the maximum exposure to credit risk of financial assets is the fair valuation (that is equivalent to book value) shown below:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Financial assets** | | |
| Cash and bank balances | **109.6** | 148.0 |
| Available for sale financial assets | **5.2** | 5.1 |
| Fair value through profit or loss | | |
| – Held for trading | **0.1** | – |
| – Designated as fair value through profit or loss | **0.8** | 0.9 |
| Held to maturity investment | **0.4** | 0.4 |
| Loans and receivables | **141.4** | 135.1 |
| Derivative instruments in designated hedge accounting relationships | **–** | 0.7 |
| | **257.5** | 290.2 |
| **Financial liabilities** | | |
| Derivative instruments in designated hedge accounting relationships | **(7.5)** | (11.2) |
| Amortised cost | **(454.1)** | (554.8) |
| | **(461.6)** | (566.0) |

### Significant accounting policies

Details of significant accounting policies are disclosed in Note 3 including criteria for recognition, basis of measurement and basis upon which income and expense are recognised.

## Capital Risk Management

The Group manages its capital structure to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

During 2012, given the level of surplus cash generated from strong trading and the Group's strong balance sheet, the Group paid dividends amounting to US$47.6m and repaid an additional US$20.0m of bank debt in addition to scheduled repayments of US$20.0m. The Group also refinanced during the year reducing overall bank loans to US$399.0m, net of fees. This represented an overall reduction of US$97.6m in bank loans during the year.

The Group was in compliance with covenants at the year-end and prior year-end. As at 31 December, the Group held:

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| Bank loans | **(399.0)** | (491.4) |
| Cash and cash equivalents | **109.6** | 148.0 |
| Net debt | **(289.4)** | (343.4) |
| Equity (net of hedging reserve) | **766.2** | 760.1 |

## Financial Risk Management

The Group's activities expose it to a variety of financial risks, market risk (including currency risk, fair value, interest rate risk and cash flow interest rate risk), credit risk and liquidity risk. The Group's overall risk management programme focuses, inter alia, on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Derivative financial instruments are used to hedge exposure to fluctuations in interest rates and foreign exchange rates that arise in the normal course of the Group's business.

Financial risk management is carried out by a central treasury department ("Group Treasury") under policies approved by the Audit Committee. Group Treasury identifies, evaluates and hedges financial risks. The Audit Committee provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investing excess liquidity.

## Market risk

*Interest rate risk management*

The Group's interest rate risk arises from long term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

At 31 December 2012, all borrowings were at floating rates. The Group manages its cash flow interest rate risk by using floating to fixed interest rate swaps or interest rate caps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates.

The Group's policy is to maintain an interest rate hedge on at least 50% of its cash paid interest floating rate debt. At 31 December 2012, 87% (2011: 56%) of the floating rate cash interest borrowings were hedged using interest rate swaps and interest rate caps.

The Group has entered into interest rate swap contracts to pay fixed and receive floating interest calculated on a net basis on notional principal amounts (Note 25).

Interest rate swaps are designated as cash flow hedges; effectiveness is tested throughout the year and they are considered to be highly effective and therefore fair value gains and losses are held in the hedging reserves.

The Group has entered into interest rate cap contracts whereby the Group receives on a net basis the excess of floating rate over the strike rate of the option based on a notional principal amount. Interest rate caps are recorded at fair value through profit or loss.

| **31 December 2012** | **Notional principal amount US$m** | **Fair value US$m** | **Weighted average fixed/ capped rate** |
|---|---|---|---|
| **Pay fixed, received floating contracts** | | | |
| **Outstanding fixed for floating contracts** | | | |
| Less than 1 year | **75.0** | **(2.1)** | **4.3%** |
| 1 – 2 years | **100.0** | **(3.8)** | **3.4%** |
| | **175.0** | **(5.9)** | **3.8%** |
| **Interest rate cap contracts** | | | |
| **Outstanding fixed for floating contracts** | | | |
| Less than 1 year | **75.0** | **–** | **3.0%** |
| 2 – 5 years | **100.0** | **0.1** | **1.2%** |
| | **175.0** | **0.1** | **1.9%** |

# Notes to the consolidated financial statements continued

## 26. Financial instruments continued

| 31 December 2011 | Notional principal amount US$m | Fair value US$m | Weighted average fixed/capped rate |
|---|---|---|---|
| **Pay fixed, received floating contracts** | | | |
| **Outstanding fixed for floating contracts** | | | |
| Less than 1 year | 25.0 | (2.7) | 4.3% |
| 2 – 5 years | 175.0 | (8.5) | 3.8% |
| | 200.0 | (11.2) | 3.8% |
| **Interest rate cap contracts** | | | |
| **Outstanding fixed for floating contracts** | | | |
| 2 – 5 years | 75.0 | – | 3.0% |

The impact of a 50 basis point fall/rise in market interest rates, including mark to market revaluations of interest rate cap derivatives on profit before tax and the offsetting loss/gain on equity as a result of mark to market revaluations of interest rate swaps, is shown below:

| | **31 December 2012** | | 31 December 2011 | |
|---|---|---|---|---|
| | **0.5% increase in interest rates US$m** | **0.5% decrease in interest rates US$m** | 0.5% increase in interest rates US$m | 0.5% decrease in interest rates US$m |
| Annualised impact on income statement (loss)/gain | **(1.9)** | **2.2** | (2.8) | 2.8 |
| Annualised impact on equity gain/(loss) | **0.7** | **(0.5)** | 1.7 | (1.7) |
| **Annualised impact on total equity (loss)/gain** | **(1.2)** | **1.7** | (1.1) | 1.1 |

### Foreign currency risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures. To manage the foreign exchange risk, Group Treasury is responsible for managing the net position in each foreign currency by using external forward currency contracts or foreign currency options.

The Group has an exposure to transactional foreign exchange arising from the currency of raw material and production costs compared to the ultimate currency of sale. The principal exposure faced by the Group is between US Dollar sales and Japanese Yen purchases. To manage this exchange risk, the Group purchases forward up to 75% of the identified foreign exchange exposures for periods up to six months and up to 50% for periods up to one year. In the current and prior years, a blend of foreign exchange forward and foreign exchange option contracts were used. All foreign exchange option contracts are recorded at fair value through profit or loss. Where foreign exchange forward contracts were designated as cash flow hedges, fair values were taken to reserves until settlement of the contract. Otherwise foreign exchange contracts were recorded at fair value through profit or loss.

The Group is exposed to the risk of revaluation to closing exchange rates of borrowings in US Dollars which are held in non US Dollar functional companies, where the revaluation to local functional currency generates exchange differences. Borrowings denominated in US Dollars held in subsidiaries which are not US Dollar functional are designated as a hedge of US Dollar denominated assets including goodwill. Where borrowings held in a subsidiary's non-functional currency cannot be designated as a net investment hedge or are not effective then revaluations to closing exchange rates are included within finance charges.

Based on the current mix of non-US Dollar denominated revenue and profit, a 1% appreciation in the Group's principal non-US Dollar currencies against the US Dollar would have had the following impact on profit after tax.

| | **2012** | 2011 |
|---|---|---|
| | **Profit after tax US$m** | Profit after tax US$m |
| Japanese Yen | **(0.4)** | (0.3) |
| Korean Won | **(0.3)** | (0.3) |
| Taiwanese Dollar | **0.4** | 0.3 |
| Euro | **(0.2)** | (0.3) |
| **Total** | **(0.5)** | (0.6) |

The movement primarily is as a result of the translation of the Group's non-US Dollar entities.

The currency split of the Group's foreign exchange derivatives, all of which mature in less than one year, is as follows;

| | 31 December 2012 | | 31 December 2011 | |
|---|---|---|---|---|
| | **Payable US$m** | **Receivable US$m** | Payable US$m | Receivable US$m |
| US Dollar | **15.4** | **–** | 23.8 | 0.4 |
| Japanese Yen | **0.8** | **14.6** | – | 24.2 |
| **Total** | **16.2** | **14.6** | 23.8 | 24.6 |

*Liquidity risk*
Prudent liquidity risk management requires maintaining sufficient cash, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions.

The Group manages liquidity risk by maintaining adequate reserves of cash and available committed facilities to meet the Group's short and long term funding requirements. The Group monitors the short term forecast and actual cash flows on a weekly basis and medium and long term requirements in line with the Group's long term planning processes.

The following table shows the Group's remaining contractual maturity for its non-derivative facilities. The amounts represent the earliest required repayments under the Group's borrowing facilities and the interest rate applicable. The table includes both principal and interest amounts. The interest amounts are not fixed and have been estimated based on the interest rates yield curves, margins and exchange rates applicable as at the year-end.

## Schedule of payments under non-derivative financial instruments including scheduled interest payments

| **31 December 2012** | **Estimated interest rate** | **0 – 6 months US$m** | **6 – 12 months US$m** | **1 – 2 years US$m** | **2 – 5 years US$m** | **Over 5 years US$m** | **Total US$m** |
|---|---|---|---|---|---|---|---|
| Bank loans | **2.38%** | **3.8** | **13.7** | **32.1** | **399.9** | **–** | **449.5** |
| **Total** | | **3.8** | **13.7** | **32.1** | **399.9** | **–** | **449.5** |

| 31 December 2011 | Estimated Interest rate | 0 – 6 months US$m | 6 – 12 months US$m | 1 – 2 years US$m | 2 – 5 years US$m | Over 5 years US$m | Total US$m |
|---|---|---|---|---|---|---|---|
| Bank loans | 2.45% | 16.2 | 16.4 | 35.0 | 477.1 | – | 544.7 |
| Total | | 16.2 | 16.4 | 35.0 | 477.1 | – | 544.7 |

The Directors consider that the Group is able to meet these commitments from existing cash and future expected cash flows. As explained in Note 23, the loan agreements contain a number of financial covenants.

The Group has access to undrawn bank facilities at 31 December 2012 of US$95.0m (2011: US$50.9m) as described in Note 23.

The undiscounted net cash outflow on the derivative financial instruments (which include interest rate and foreign exchange derivatives) is shown below. Where the amount payable or receivable is not fixed, the amount disclosed has been estimated based on the interest rate yield curves and exchange rates applicable as at 31 December.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | **Payable US$m** | **Receivable US$m** | Payable US$m | Receivable US$m |
| Within six months | **19.1** | **14.6** | 17.6 | 14.9 |
| In seven to twelve months | **3.0** | **–** | 12.6 | 9.7 |
| In one to two years | **0.7** | **–** | 5.3 | – |
| In two to five years | **–** | **–** | 0.6 | – |
| **Total** | **22.8** | **14.6** | 36.1 | 24.6 |

*Credit risk*
Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as exposures to outstanding receivables from customers. Derivative counterparties and cash transactions are limited to high-credit quality financial institutions. The Group has policies that limit the amount of credit exposure to any financial institution.

The Group also has policies in place to ensure that sales of products are made to customers with an appropriate credit history. Further details of customer related credit risk can be found in Note 19 to the financial statements.

### Fair value of financial instruments
Except as detailed in Note 23, the carrying amounts of financial assets and financial liabilities recorded in the financial statements approximate their fair values.

# Notes to the consolidated financial statements continued

## 26. Financial instruments continued

### Valuation techniques and assumptions applied for the purpose of measuring fair value

Where available the fair values for derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives. Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

### Fair value measurements recognised in the statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2 fair value measurements are those derived from input other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e. as prices) or indirectly (derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

### Fair value measurements recognised in the statement of financial position

| **At 31 December 2012** | **Level 2 US$m** | **Level 3 US$m** | **Total US$m** |
|---|---|---|---|
| **Financial assets at fair value** | | | |
| Investments | **–** | **0.8** | **0.8** |
| Derivative financial assets | **0.1** | **–** | **0.1** |
| **Financial liabilities at fair value** | | | |
| Derivative financial liabilities | **(7.5)** | **–** | **(7.5)** |

| At 31 December 2011 | Level 2 US$m | Level 3 US$m | Total US$m |
|---|---|---|---|
| **Financial assets at fair value** | | | |
| Investments | – | 0.9 | 0.9 |
| Derivative financial assets | 0.7 | – | 0.7 |
| **Financial liabilities at fair value** | | | |
| Derivative financial liabilities | (11.2) | – | (11.2) |

### Reconciliation of Level 3 fair value measurements of financial instrument assets:

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| As at start of the year | **0.9** | 0.8 |
| Total gains or losses: | | |
| In profit or loss (fair value adjustment) | **(0.1)** | 0.1 |
| In other comprehensive income | **–** | – |
| **As at end of the year** | **0.8** | 0.9 |

Level 3 financial assets comprise the Group's interest in Infraserv, carried at fair value as disclosed in Note 17.

## 27. Share-based payments

The Group recognised total expense of US$1.7m (2011: US$0.7m) in relation to equity-settled share-based payment transactions and a total charge of US$0.2m (2011: US$0.2m credit) in relation to cash-settled share-based payment transactions during the year.

### Long Term Incentive Plan (LTIP)

The LTIP facilitates the granting of awards over Ordinary shares in the Company for nil consideration. Further outline details are provided in the Remuneration Report on pages 64 to 73.

*Equity-settled share options*

During the current year and prior years, under the LTIP, the Group issued to certain employees share options exercisable at a price equal to the market price of the Company's shares on the date of grant. The vesting period is three years with the majority of the options subject to the satisfaction of certain financial performance conditions before they can be exercised. The earnings per share performance conditions are discussed in the Remuneration Report. If the options remain unexercised after a period of ten years from the date of grant the options expire. Options are normally forfeited if the employee leaves the Group before the options vest. Details of the share options outstanding during the year are as follows:

| | 2012 Number of Ordinary shares under option | 2012 Weighted average exercise price (in £) | 2011 Number of Ordinary shares under option | 2011 Weighted average exercise price (in £) |
|---|---|---|---|---|
| Outstanding at start of the year | **2,778,793** | **2.40** | 2,415,991 | 2.40 |
| Granted during the year | **1,956,429** | **2.94** | 465,356 | 2.47 |
| Forfeited during the year | **(165,169)** | **2.42** | (102,554) | 2.54 |
| **Outstanding at the end of the year** | **4,570,053** | **2.63** | 2,778,793 | 2.40 |
| **Exercisable at the end of the year** | **–** | **–** | – | – |

There were no options exercised during the year. The weighted average remaining contractual life of the options at the year-end is 8.5 years.

In 2012, options were granted on 10 April and 3 September. In 2011, options were granted on 8 April and 31 August. The value of the share options has been calculated using the Black-Scholes model. The key assumptions underlying this value for options granted during the year are as follows:

| | 2012 | 2011 |
|---|---|---|
| Expected term | **4 years** | 4 years |
| Weighted average share price at grant | **GBP2.96** | GBP2.47 |
| Weighted average exercise price | **GBP2.94** | GBP2.47 |
| Risk free rate | **0.64% – 1.00%** | 1.55% – 2.75% |
| Expected volatility | **30%** | 30% |
| Expected dividend yields | **2.47% – 2.63%** | 2.32% – 3.27% |
| Weighted average fair value per share | **US$0.90** | US$0.81 |

Expected volatility was determined by calculating the historical volatility of the Group's peer companies' share prices over the previous five years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

*Equity settled share awards*
During the current year and prior year, under the LTIP, the Group issued to certain employees share awards. The vesting period is three years with the awards subject to the satisfaction of certain financial performance conditions before they vest. Awards are normally forfeited if the employee leaves the Group before the awards vest. The performance conditions are based on Total Shareholder Returns ("TSR") and these are discussed further in the Remuneration Report.

| | 2012 Number of Ordinary shares awarded | 2012 Weighted average exercise price (in £) | 2011 Number of Ordinary shares awarded | 2011 Weighted average exercise price (in £) |
|---|---|---|---|---|
| Outstanding at start of the year | **381,452** | **–** | – | – |
| Granted during the year | **531,071** | **–** | 409,541 | – |
| Forfeited during the year | **(63,181)** | **–** | (28,089) | – |
| **Outstanding at the end of the year** | **849,342** | **–** | 381,452 | – |
| **Exercisable at the end of the year** | **–** | **–** | – | – |

No awards vested during the year. The weighted average remaining contractual life of the awards at the year-end is 1.9 years.

In 2012, awards were granted on 10 April and 3 September. In 2011, awards were granted on 8 April and 1 September. The value of the share awards has been calculated using the stochastic (Monte Carlo) model. The key assumptions underlying this value for awards granted during the year are as follows:

| | 2012 | 2011 |
|---|---|---|
| Expected term | **3 years** | 3 years |
| Weighted average share price at grant | **GBP2.96** | GBP2.67 |
| Weighted average exercise price | **nil** | nil |
| Risk free rate | **0.50%** | 0.70% – 1.90% |
| Expected volatility | **35%** | 39% – 44% |
| Expected dividend yield | **2.60%** | 2.32% – 3.27% |
| Weighted average fair value per share | **US$2.57** | US$2.47 |

Expected volatility was determined by calculating the historical volatility of the Group's peer companies' share prices over the previous three years.

# Notes to the consolidated financial statements continued

## 27. Share-based payments continued

*Cash-settled share options*

In prior years, under the LTIP, the Group issued to certain employees share appreciation rights that vest after three years. After the vesting date, employees will be paid a cash equivalent for each option exercised, being the difference between the exercise price and market price of an AZ Ordinary share at the exercise date. Options are normally forfeited if the employee leaves the Group before the options vest. Details of these options outstanding during the year are as follows:

| | **2012 Number of Ordinary shares under option** | **2012 Weighted average exercise price (in £)** | 2011 Number of Ordinary shares under option | 2011 Weighted average exercise price (in £) |
|---|---|---|---|---|
| Outstanding at start of the year | **228,077** | **2.43** | 270,679 | 2.40 |
| Granted during the year | **–** | **–** | 17,462 | 2.76 |
| Forfeited during the year | **(16,116)** | **2.45** | (60,064) | 2.40 |
| **Outstanding at the end of the year** | **211,961** | **2.43** | 228,077 | 2.43 |
| **Exercisable at the end of the year** | **–** | **–** | – | – |

There were no options exercised during the year. The weighted average remaining contractual life of the options at the year-end is 7.9 years.

The value of the cash-settled share options has been remeasured at the balance sheet date using the Black-Scholes model. The key assumptions underlying the fair value for options outstanding at the year end is as follows:

| | **2012** | 2011 |
|---|---|---|
| Average expected remaining term | **2 years** | 3 years |
| Share price at 31 December | **GBP3.49** | GBP2.40 |
| Weighted average exercise price | **GBP2.43** | GBP2.43 |
| Risk free rate | **0.31%** | 1.04% |
| Expected volatility | **30%** | 30% |
| Expected dividend yield | **2.35%** | 3.24% |

The Group has recorded liabilities of US$0.3m at the year-end (2011: US$0.1m) in relation to cash-settled share-based payment transactions.

Expected volatility was determined by calculating the historical volatility of the Group's peer companies' share prices over the previous five years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### Restricted stock award

On 31 August 2011, the Group granted 112,654 shares to a Director as a restricted stock award of which 50% vested on 3 September 2012 and were satisfied by shares from the ESOP trust. The remaining 50% will vest on 3 September 2013 subject to continued employment.

The value of the share award has been calculated using the Black-Scholes model. The key assumptions underlying this value for awards granted during the prior year was as follows:

| | 2011 |
|---|---|
| Number of Ordinary shares granted | 112,654 |
| Expected term | 11 – 23 months |
| Share price at grant | GBP2.28 |
| Exercise price | nil |
| Expected dividend yield | 3.27% |
| Average fair value per share | US$3.52 |

## Employee ShareMatch Plan

As disclosed in the Directors' report on pages 48 to 51, the Group made its first invitation under its Employee ShareMatch Plan in May 2012. The plan includes one free share for every four shares purchased in the market, deliverable on the first anniversary of purchase.

The value of the free shares awarded has been calculated using the Black-Scholes model. The key assumptions underlying this value for awards granted during the year was as follows:

| | 2012 |
|---|---|
| Number of Ordinary shares granted | **44,126** |
| Expected term | **12 months** |
| Share price at grant | **GBP3.25** |
| Exercise price | **nil** |
| Expected dividend yield | **2.49%** |
| Average fair value per share | **US$4.83** |

As at 31 December 2012, there were 43,982 shares (2011:nil) outstanding, as free matching shares, under the Employee ShareMatch Plan, all of which are expected to vest in May 2013.

## 28. Retirement benefit obligations

The amounts recognised in the balance sheet in respect of retirement benefit obligations are as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Defined pension benefit plans – unfunded | **10.7** | 9.8 |
| Other post-employment defined benefit plans | | |
| – Unfunded | **2.0** | 2.0 |
| – Partly funded | **3.1** | 2.6 |
| **Total** | **15.8** | 14.4 |

## Defined benefit schemes

The Group operates unfunded defined benefit schemes for qualifying employees of its subsidiary in Germany. Under the schemes, employees accrue a right to a yearly pension on attainment of a retirement age of 65 based on employee's annual pensionable salary. There are no assets in the scheme as all liabilities are recognised as the Group is required to cover the pension promise.

The Group also operates other post-employment defined benefit plans in Germany, France, South Korea and India. In Germany the Group operates an early retirement scheme which is unfunded. In France the Group operates a scheme where employees receive a lump sum on retirement and also a post-retirement medical benefit scheme both of which are unfunded. In South Korea the Group operates a scheme where employees receive a lump sum on retirement which is partly funded by the Group. In India the Group operates a scheme where employees receive a lump sum on retirement which is partly funded by the Group.

## Significant accounting policies

Details of significant accounting policies are disclosed in Note 3 including criteria for recognition, basis of measurement and basis upon which income and expense are recognised.

The present value of the defined benefit obligation, the related current service cost and past service cost, were measured using the projected unit credit method. The projected unit credit method is an accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings. At 31 December 2012, the accumulated benefit obligation in relation to the defined benefit schemes was US$26.1m (2011: US$20.6m).

During the year, the Group accounted for retirement benefits using the corridor approach and as at 31 December 2012 there were unrecognised actuarial losses of US$7.1m (2011: US$3.2m). As a result of amendments to IAS 19 "Employee benefits" the corridor approach is discontinued and all unrecognised actuarial gains and losses will be recognised in other comprehensive income from 1 January 2013.

# Notes to the consolidated financial statements continued

## 28. Retirement benefit obligations continued

### Key assumptions used:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| **Discount rate** | | | |
| Germany | **0.8% – 3.1%** | 2.9% – 4.6% | 3.4% – 5.1% |
| France | **2.1% – 3.2%** | 3.6% – 4.5% | 3.8% – 5.1% |
| South Korea | **3.1%** | 3.7% | 4.3% |
| India | **8.2%** | 9.0% | – |
| **Expected return on plan assets** | | | |
| South Korea | **4.0%** | 4.0% | 4.0% |
| India | **8.2%** | – | – |
| **Future salary increases** | | | |
| Germany | **2.75%** | 2.75% | 2.75% |
| France | **3.0%** | 3.0% | 3.0% |
| South Korea | **6.0%** | 5.5% | 5.5% |
| India | **6.0%** | 6.0% | – |
| **Future pension increases** | | | |
| Germany | **2.0%** | 2.0% | 2.0% |
| **Long term increase in health costs** | | | |
| France | **6.0%** | 6.0% | 6.0% |

The basis used to determine the overall rate expected on return on assets is the observed return on the plan assets.

The assumed life expectations on retirement at age 65 in relation to defined benefit pension benefit plans are:

| | 2012 years | 2011 years | 2010 years |
|---|---|---|---|
| Retiring today | | | |
| Males | **18.9** | 18.8 | 18.6 |
| Females | **23.0** | 22.8 | 22.7 |
| Retiring in 20 years | | | |
| Males | **21.6** | 21.4 | 21.3 |
| Females | **25.5** | 25.4 | 25.3 |

The amount included in the balance sheet arising from the Group's obligations in respect of defined benefit retirement schemes is as follows:

| | 2012 US$m | 2011 US$m | 2010 US$m | 2009 US$m | 2008 US$m |
|---|---|---|---|---|---|
| Present value of defined benefit obligations | **26.1** | 20.6 | 17.4 | 15.8 | 13.3 |
| Fair value of plan assets | **(3.1)** | (2.9) | (3.2) | (2.5) | (2.3) |
| Deficit in the schemes | **23.0** | 17.7 | 14.2 | 13.3 | 11.0 |
| Unrecognised actuarial (losses)/gains | **(7.1)** | (3.2) | (0.5) | 0.4 | 0.7 |
| Past service cost | **(0.1)** | (0.1) | (0.2) | – | (0.1) |
| **Liability in the balance sheet** | **15.8** | 14.4 | 13.5 | 13.7 | 11.6 |
| Experience adjustments on scheme liabilities | **0.1** | (1.7) | (0.4) | 1.4 | (0.1) |
| Experience adjustments on scheme assets | **–** | – | – | – | – |

The movement in the present value of defined benefit obligations is as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Opening balance | **20.6** | 17.4 |
| Service cost | **1.5** | 1.3 |
| Interest cost | **0.8** | 0.8 |
| Past service cost | **0.1** | – |
| Benefits paid | **(0.6)** | (1.1) |
| Curtailment | **(1.2)** | – |
| Actuarial gains and losses | **4.1** | 2.7 |
| Balance on acquisition | **–** | 0.1 |
| Exchange differences | **0.8** | (0.6) |
| **Closing balance** | **26.1** | 20.6 |

Movement in the fair value of defined benefit plan assets were as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Opening balance | **2.9** | 3.2 |
| Expected return on scheme assets | **0.1** | 0.1 |
| Contributions | **0.9** | 0.5 |
| Settlements | **(0.8)** | – |
| Benefits paid | **(0.2)** | (0.9) |
| Exchange differences | **0.2** | – |
| **Closing balance** | **3.1** | 2.9 |

The actual return on scheme assets in the year was US$0.1m (2011:US$0.1m).

All of the scheme assets for the current and prior year are held in insurance policies. The assets do not contain any direct investment in the Group's shares, property or other assets.

The amounts recognised in the income statement in respect of defined benefit schemes are as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Current service cost | **1.5** | 1.3 |
| Amortisation of actuarial losses | **0.3** | – |
| Past service cost | **0.1** | – |
| Gain on settlement/curtailment | **(0.1)** | – |
| Expected return on scheme assets | **(0.1)** | (0.1) |
| Interest cost | **0.8** | 0.8 |
| **Total charge to income statement** | **2.5** | 2.0 |

The charge for the year is recognised as follows:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Administrative expenses | **1.7** | 1.2 |
| Finance costs | **0.8** | 0.8 |
| **Total charge for the year** | **2.5** | 2.0 |

The estimated charge to the income statement during the next financial year is US$2.6m.

# Notes to the consolidated financial statements continued

## 28. Retirement benefit obligations continued

### Sensitivity Analysis

The sensitivities regarding the principal assumptions used to measure the liabilities of the schemes are set out below. Inflation is not considered significant to the post-employment benefit schemes.

*Sensitivity – discount rate*

| | **31 December 2012 US$m** | | 31 December 2011 US$m | | 31 December 2010 US$m | |
|---|---|---|---|---|---|---|
| | **Decrease discount rate 0.5%** | **Increase discount rate 0.5%** | Decrease discount rate 0.5% | Increase discount rate 0.5% | Decrease discount rate 0.5% | Increase discount rate 0.5% |
| (Increase)/decrease in defined benefit plan liability | **(1.5)** | **1.4** | (1.0) | 1.1 | (1.0) | 1.0 |

*Sensitivity – salary*

| | **31 December 2012 US$m** | | 31 December 2011 US$m | | 31 December 2010 US$m | |
|---|---|---|---|---|---|---|
| | **Decrease salaries 0.5%** | **Increase salaries 0.5%** | Decrease salaries 0.5% | Increase salaries 0.5% | Decrease salaries 0.5% | Increase salaries 0.5% |
| Decrease/(increase) in defined benefit plan liability | **0.7** | **(0.7)** | 0.3 | (0.3) | 0.4 | (0.4) |

*Sensitivity – Medical Cost Trend Rate (MCTR)*

| | **31 December 2012 US$m** | | 31 December 2011 US$m | | 31 December 2010 US$m | |
|---|---|---|---|---|---|---|
| | **Decrease MCTR 1%** | **Increase MCTR 1%** | Decrease MCTR 1% | Increase MCTR 1% | Decrease MCTR 1% | Increase MCTR 1% |
| Decrease/(increase) in defined benefit plan liability | **0.1** | **(0.1)** | 0.1 | (0.1) | 0.1 | (0.1) |

### Multi-employer Plan

The Group contributes to a multi-employer defined benefit pension scheme for employees in Germany. The Group does not have sufficient information available to enable it to calculate its share of any deficit or surplus and therefore accounts for the multi-employer plan as a defined contribution plan. Under the plan, the Group would be required to increase its contributions to the plan where the plan was unable to meet its obligations to the participants. During the year the Group contributed US$0.5m (2011: US$0.6m) to the plan.

## 29. Trade and other payables

| | **2012 US$m** | 2011 US$m |
|---|---|---|
| Trade payables | **55.0** | 62.5 |
| Amounts due to related parties | **0.5** | 0.1 |
| Social security and other taxes | **6.3** | 5.6 |
| Interest accrual | **0.9** | 1.9 |
| Bonus accrual | **12.5** | 13.7 |
| Accrued expenses and other creditors | **37.0** | 38.3 |
| **Total** | **112.2** | 122.1 |

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases, as at 31 December 2012, was 35 days (2011: 40 days). The Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

The Directors consider that the carrying amount of trade payables approximates their fair value.

## 30. Acquisition of subsidiary

There were no acquisitions made during the current year.

On 1 October 2011, the Group acquired the polysilazanes coatings and resins business of Clariant AG. This transaction comprised of the purchase of 100% of the issued share capital of Chemtreat Composites Private Limited, an Indian company producing organic polysilazanes as well as certain laboratory assets, intellectual property and contracts.

The Group paid US$5.3m in cash for the net assets acquired, including intangible assets for which a provisional fair value of US$3.3m was confirmed during 2012.

## 31. Cash generated from operations

| | Notes | 2012 US$m | 2011 US$m |
|---|---|---|---|
| **Profit for the year** | | **82.9** | 96.5 |
| **Adjustments for:** | | | |
| Income tax expense | 11 | **46.2** | 29.1 |
| Depreciation on property, plant and equipment | 5 | **29.1** | 28.0 |
| Amortisation of intangible assets | 5 | **82.6** | 82.3 |
| (Gain)/loss on sale of property, plant and equipment | | **(0.1)** | 0.4 |
| Share-based payments charge | | **1.9** | 0.5 |
| Finance costs | | **21.2** | 27.3 |
| Investment incomes | | **(0.9)** | (0.7) |
| Exchange differences on financial liabilities | | **2.1** | (0.6) |
| **Changes in working capital:** | | | |
| Decrease/(increase) in inventories | | **2.5** | (3.6) |
| Increase in trade and other receivables | | **(7.2)** | (4.3) |
| (Decrease)/increase in trade and other payables | | **(3.8)** | 0.1 |
| **Cash generated from operations** | | **256.5** | 255.0 |
| Income taxes paid | 11 | **(84.9)** | (75.3) |
| Interest paid | | **(19.4)** | (24.6) |
| **Net cash from operating activities** | | **152.2** | 155.1 |

## 32. Contingencies

At 31 December 2012, the Group had given no guarantees in the ordinary course of business to third parties (2011: US$nil) other than the security disclosed in Note 23.

## 33. Operating leases

The Group leases various manufacturing sites, offices and warehouses under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

The Group also leases various plant and machinery under cancellable operating lease agreements. The Group is required to give a varying number of months notice for the termination of these agreements.

Minimum lease payments under operating leases recognised as expense in the year:

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Property | **6.0** | 5.6 |
| Plant and machinery | **1.1** | 1.1 |
| **Total** | **7.1** | 6.7 |

At the balance sheet date, the Group had the following outstanding non-cancellable operating lease commitments, which fall due as follows:

| | Property US$m | Plant & Machinery US$m | Total US$m |
|---|---|---|---|
| **31 December 2012** | | | |
| Within one year | **5.1** | **0.9** | **6.0** |
| In the second to fifth years inclusive | **6.3** | **0.9** | **7.2** |
| After five years | **3.1** | **–** | **3.1** |
| **Total** | **14.5** | **1.8** | **16.3** |
| 31 December 2011 | | | |
| Within one year | 4.7 | 0.8 | 5.5 |
| In the second to fifth years inclusive | 4.3 | 1.0 | 5.3 |
| Total | 9.0 | 1.8 | 10.8 |

# Notes to the consolidated financial statements continued

## 34. Related party transactions

Transactions between AZ Electronic Materials S.A. and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

The Carlyle Group was considered a related party during the prior year as Franck Falézan, a Director of AZ until 31 December 2011, was also a Director and Partner of The Carlyle Group.

Vestar Capital Partners was considered a related party during the prior year as Jean-François Félix, a Director of AZ until 31 December 2011, was also a Director of Vestar Capital Partners.

The following transactions were carried out with related parties:

*Key management compensation*

The remuneration of Directors and other members of key management during the year is set out below in aggregate for each of the categories specified in IAS 24 "Related Party Disclosures". Further information about the remuneration of individual Directors is provided in the audited part of the Remuneration Report on pages 64 to 73.

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Short term employee benefits | **6.0** | 5.6 |
| Post-employment benefits | **0.3** | 0.2 |
| Share-based payments | **1.1** | 0.4 |
| | **7.4** | 6.2 |

During the year, the Group facilitated certain share transactions on behalf of and as directed by key management. At the year-end, the Group owed US$0.5m (2011: US$nil) to a key manager.

*Balances arising from purchases of services*

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Balance sheet** | | |
| Payable to The Carlyle Group | **–** | (0.1) |
| Payable to Vestar Capital Partners | **–** | – |
| | **–** | (0.1) |
| **Income statement – fees for services** | | |
| The Carlyle Group | **–** | 0.1 |
| Vestar Capital Partners | **–** | 0.1 |
| | **–** | 0.2 |

During the prior year, the Group incurred US$0.1m in relation to services provided by The Carlyle Group in respect of directors' fees.

During the prior year, the Group incurred US$0.1m in relation to services provided by Vestar Capital Partners in respect of directors' fees.

## 35. Investment in subsidiaries

Details of AZ Electronic Materials S.A. principal subsidiaries at 31 December 2012 are as follows:

| Name | | Place of incorporation (or registration) and operation | Proportion of ownership interest | Proportion of voting power held | Method used to account for investment |
|---|---|---|---|---|---|
| AZ Electronic Materials (Luxembourg) S.à r.l. | * | Luxembourg | 100% | 100% | Consolidated |
| Ridgefield Acquisition S.à r.l. | * | Luxembourg | 100% | 100% | Consolidated |
| AZ Electronic Materials (Japan) K.K. | | Japan | 100% | 100% | Consolidated |
| AZ Electronic Materials Manufacturing (Japan) K.K. | | Japan | 100% | 100% | Consolidated |
| AZ Electronic Materials IP (Japan) K.K. | | Japan | 100% | 100% | Consolidated |
| AZ Electronic Materials (Korea) Ltd | | South Korea | 100% | 100% | Consolidated |
| AZ Electronic Materials Taiwan Co Ltd | | Taiwan | 100% | 100% | Consolidated |
| AZ Electronic Materials (Suzhou) Limited | | China | 100% | 100% | Consolidated |
| AZ Electronic Materials Hong Kong Ltd | | Hong Kong | 100% | 100% | Consolidated |
| AZ Electronic Materials Hong Kong Services Ltd | | Hong Kong | 100% | 100% | Consolidated |
| AZ Electronic Materials Germany GmbH | | Germany | 100% | 100% | Consolidated |
| AZ Electronic Materials France SAS | | France | 100% | 100% | Consolidated |
| AZ Electronic Materials USA Corp | | USA | 100% | 100% | Consolidated |
| AZ Electronic Materials Services Ltd | | UK | 100% | 100% | Consolidated |
| AZ Electronics Materials (Singapore) PTE Ltd | | Singapore | 100% | 100% | Consolidated |
| Chemtreat Composites India Pvt Ltd | | India | 100% | 100% | Consolidated |

The subsidiaries marked * are holding companies; the remaining companies are operating companies.

# Annual accounts of AZ Electronic Materials S.A.

## AZ Electronic Materials S.A.

# Report of the réviseur d'entreprises agréé

To the Shareholders of
AZ Electronic Materials S.A.
32-36,Boulevard d'Avranches
L-1160 Luxembourg

## Report on the annual accounts

Following our appointment by the General Meeting of Shareholders dated 2 May 2012, we have audited the accompanying annual accounts of AZ Electronic Materials S.A., set out on pages 116 to 121, which comprise the balance sheet as at 31 December 2012 and the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Responsibility of the Board of Directors for the annual accounts

The Board of Directors is responsible for the preparation and fair presentation of these annual accounts in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts, and for such internal control as the Board of Directors determines is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

### Responsibility of the réviseur d'entreprises agréé

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted for Luxembourg by the *Commission de Surveillance du Secteur Financier*. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the judgement of the *réviseur d'entreprises agréé*, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the *réviseur d'entreprises agréé* considers internal control relevant to the entity's preparation and fair presentation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the annual accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the annual accounts give a true and fair view of the financial position of AZ Electronic Materials S.A. as at 31 December 2012, and of its operations for the year then ended in accordance with the Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts.

## Report on other legal and regulatory requirements

The Management Report set out on pages 48 to 51, which is the responsibility of the Board of Directors, is consistent with the annual accounts.

For Deloitte Audit,
*Cabinet de révision agréé*

**John Psaila**
Réviseur d'entreprises agréé
Partner

560, rue de Neudorf
L-2220 Luxembourg
Grand Duchy of Luxembourg

18 February 2013

# Annual accounts of AZ Electronic Materials S.A.
## Balance sheet
As at 31 December 2012

| | Notes | 2012 US$m | 2011 US$m |
|---|---|---|---|
| **ASSETS** | | | |
| **Fixed assets** | | | |
| Financial assets | | | |
| – shares in affiliated undertakings | 3 | **1,551.3** | 1,605.5 |
| – loans to affiliated undertakings | 3 | **2.5** | – |
| **Total fixed assets** | | **1,553.8** | 1,605.5 |
| **Current assets** | | | |
| Debtors | | | |
| Other receivables | | | |
| – becoming due and payable within one year | | **–** | 0.3 |
| Cash at bank and in hand | | **1.0** | 0.2 |
| **Total current assets** | | **1.0** | 0.5 |
| **TOTAL ASSETS** | | **1,554.8** | 1,606.0 |
| **LIABILITIES** | | | |
| **Equity** | | | |
| Subscribed capital | 4 | **38.1** | 38.1 |
| Share issue and equivalent premiums | 4 | **390.0** | 390.0 |
| Other reserves | 6 | **1,175.5** | 1,222.4 |
| Loss brought forward | | **(35.6)** | (34.4) |
| Loss for the year | | **(5.7)** | (1.2) |
| Interim dividends | 7 | **(15.2)** | (14.5) |
| **Total equity** | | **1,547.1** | 1,600.4 |
| **Provisions** | | | |
| Other provisions | 8 | **3.1** | 1.4 |
| **Total provisions** | | **3.1** | 1.4 |
| **Non-subordinated debts** | | | |
| **Amounts owed to affiliated undertakings** | | | |
| – becoming due and payable within one year | 9 | **2.8** | 3.8 |
| **Tax and social security debts** | | | |
| – Tax | | **0.6** | – |
| **Other creditors** | | | |
| – becoming due and payable within one year* | | **1.2** | 0.4 |
| **Total non-subordinated debts** | | **4.6** | 4.2 |
| **TOTAL LIABILITIES** | | **1,554.8** | 1,606.0 |

The accompanying Notes are integral to these annual accounts.

* The titles and subheadings of other creditors have been changed from those used in the previous financial year. Consequently the comparatives have been restated where applicable.

# Annual accounts of AZ Electronic Materials S.A.
## Profit and loss account
As at 31 December 2012

| | Notes | For the year ended 31 December 2012 US$m | For the year ended 31 December 2011 US$m |
|---|---|---|---|
| **Charges** | | | |
| Other operating charges | 12 | **7.8** | 2.2 |
| Interest payable and similar charges | | | |
| – concerning affiliated undertakings | | **0.1** | – |
| **Total charges** | | **7.9** | 2.2 |
| **Income** | | | |
| Other operating income | 13 | **2.0** | 1.0 |
| Other interests and other financial income | | | |
| – derived from affiliated undertakings | | **0.2** | – |
| Loss for the year | | **5.7** | 1.2 |
| **Total income** | | **7.9** | 2.2 |

The accompanying Notes are integral to these annual accounts.

# Annual accounts of AZ Electronic Materials S.A.
## Notes to the accounts
As at 31 December 2012

### 1. General
AZ Electronic Materials S.A. ("Company") is a Luxembourg public limited liability company *(Société Anonyme)* incorporated on 12 October 2010. The Company is registered at the Register of Trade and Commerce of Luxembourg under the number B156074.

The registered office is established at 32-36, Boulevard d'Avranches, L-1160 Luxembourg.

The Company's financial period corresponds to the calendar year.

The object of the Company is the holding of participations, in any form whatsoever, in other Luxembourg or foreign companies, the control, the management, as well as the development of these participations.

In conformity with the requirements of Luxembourg laws and regulations, the Company publishes consolidated financial statements in accordance with International Financial Reporting Standards as adopted in the European Union.

### 2. Summary of significant accounting policies

#### Basis of preparation
The annual accounts have been prepared in accordance with Luxembourg legal and regulatory requirement under the historical cost convention.

Accounting policies and valuation rules are, besides the ones laid down by the Law of 19 December 2002, determined and applied by Management.

The preparation of the annual accounts requires the use of certain critical accounting estimates. It also requires the management to exercise their judgement in the process of applying the accounting policies. Changes in assumptions may have a significant impact on the annual accounts in the periods in which the assumptions changed. Management believes that the underlying assumptions are appropriate and that the annual accounts therefore present the financial position and the results fairly.

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities in the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### Principal valuation rules
The principal valuation rules of the Company can be summarised as follows:

*Financial fixed assets*
Shares in affiliated undertakings and loans to these held as fixed assets are valued at their historical acquisition cost including the incidental costs of acquisition.

When the management considers that a durable impairment in value of financial assets exists, a value adjustment will be made, so that they are valued at the lower value to be attributed to them at the balance sheet date. These value adjustments may not be continued if the reasons for which the value adjustments were made have ceased to apply.

*Debtors*
Debtors are valued at nominal value.

*Creditors*
Creditors are valued at nominal value.

*Foreign currency translation*
All the transactions expressed in another currency than the currency in which the capital is denominated are translated in the currency in which the capital is denominated at the exchange rate prevailing at the date of transaction.

All assets and liabilities are valued individually at their value determined at the exchange rate prevailing at the balance sheet date. Exchange differences are accounted for in the profit and loss account. Unrealised valuation gains on long term loans used to finance investments are not recognised, although unrealised valuation losses are provided in full.

*Share based payments*
The Company has issued share options to the employees of affiliated undertakings. Equity-settled and cash-settled share-based payments are measured initially at the fair value of the liability. For equity-settled payments the fair value determined at grant is expensed on a straight-line basis over the vesting period. For cash-settled payments the fair value is remeasured at the balance sheet date with any changes in fair value recognised in the profit or loss for the year.

*Dividends*
Dividends received as a result of share premium distributions are accounted for as a decrease in the carrying value of the related subsidiary in so far as such dividends are in substance a reimbursement of the original investment. In other instances, dividends are recorded within income on receipt.

## 3. Financial assets

| Acquisition cost and net book value | Shares in affiliated undertakings | Loans to affiliated undertakings US$m | Total US$m |
|---|---|---|---|
| As at 1 January 2012 | 1,605.5 | – | 1,605.5 |
| Dividend received in the form of share premium reimbursement | (54.2) | – | (54.2) |
| Additions | – | 2.5 | 2.5 |
| **As at 31 December 2012** | **1,551.3** | **2.5** | **1,553.8** |

### Shares in affiliated undertakings

On 26 April 2012, AZ Electronic Materials Topco S.à r.l. repaid share premium to the Company amounting to US$54.2m.

Shares in affiliated undertakings is comprised of 100% of the share capital of AZ Electronics Materials Topco S.à r.l., registered office 32-36, Boulevard d'Avranches, L-1160 Luxembourg.

### Loans to affiliated undertakings

| Becoming due and payable within one year | **2012 US$m** | 2011 US$m |
|---|---|---|
| Due from AZ Electronic Materials (Luxembourg) S.à r.l. | **2.5** | – |
| **Total** | **2.5** | – |

## 4. Subscribed capital and share premium

The subscribed capital amounts to US$38.1m and is divided into 380,913,552 shares fully paid up with a nominal value of US$0.10 per share.

The total number of authorised Ordinary shares is 920,000,000 with a par value of US$0.10 per share. All shares rank equally on liquidation.

| | No. of shares | Share capital US$m | Share premium US$m | Total US$m |
|---|---|---|---|---|
| **As at 1 January 2012 and 31 December 2012** | **380,913,552** | **38.1** | **390.0** | **428.1** |

## 5. Legal reserve

In accordance with Luxembourg Company Law, the Company is required to transfer a minimum of 5% of its net profit for each financial year to a legal reserve. This requirement ceases to be necessary once the balance on the legal reserve reaches 10% of the issued share capital. The legal reserve is not available for distribution to shareholders. To date, the Company has not made any net profits and thus there is no legal reserve.

## 6. Other reserves

| | Total US$m |
|---|---|
| As at 1 January 2012 | 1,222.4 |
| Allocation of 2011 interim dividend | (14.5) |
| Allocation of 2011 final dividend | (32.4) |
| **As at 31 December 2012** | **1,175.5** |

On 12 October 2010, the Company's shareholders resolved to effect a reduction in the share capital of the Company by crediting a distributable reserve (the "Capital reduction reserve"). The Group is able to utilise this Capital reduction reserve to pay distributions to shareholders.

## 7. Interim dividends

The payment of an interim dividend was decided during the Board of Directors' meeting held on 22 August 2012, on the basis of an interim position as at 30 June 2012. The interim dividend is a distribution to shareholders and is to be allocated against other distributable reserves (the "Capital reduction reserve") at the Company's AGM in 2013.

# Annual accounts of AZ Electronic Materials S.A.
## Notes to the accounts continued
As at 31 December 2012

### 8. Other provisions

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Provision for equity-settled share-based payment transactions | **2.8** | 1.3 |
| Provision for cash-settled share-based payment transactions | **0.3** | 0.1 |
| **Total** | **3.1** | 1.4 |

*Equity-settled share options*
The Company has issued to certain employees of affiliated undertakings share options exercisable at a price equal to the market price of the Company's shares on the date of grant. The vesting period is three years with the majority of the options subject to the satisfaction of certain financial performance conditions before they can be exercised. Options are normally forfeited if the employee leaves the Group before the options vest. Details of the share options outstanding during the year are as follows:

| | Number of Ordinary shares under option | Weighted average exercise price (in £) |
|---|---|---|
| Outstanding as at 1 January 2012 | 2,778,793 | 2.40 |
| Granted during the year | 1,956,429 | 2.94 |
| Forfeited during the year | (165,169) | 2.42 |
| **Outstanding as at 31 December 2012** | **4,570,053** | **2.63** |

*Cash-settled share options*
The Company has issued to certain employees of affiliated undertakings share appreciation rights that vest after three years. At the vesting date, employees are paid a cash equivalent for each option exercised, being the difference between the exercise price and market price of an AZ Ordinary share at the exercise date. Options are normally forfeited if the employee leaves the Group before the options vest. Details of the options outstanding during the year are as follows:

| | Number of Ordinary shares under option | Weighted average exercise price (in £) |
|---|---|---|
| Outstanding as at 1 January 2012 | 228,077 | 2.43 |
| Forfeited during the year | (16,116) | 2.45 |
| **Outstanding as at 31 December 2012** | **211,961** | **2.43** |

*Equity-settled share awards*
The Company has issued to certain employees of affiliated undertakings share awards exercisable at nil cost. The vesting period is three years with the awards subject to the satisfaction of certain financial performance conditions before they vest. Awards are normally forfeited if the employee leaves the Group before the awards vest. Details of the share awards outstanding during the year are as follows:

| | Number of Ordinary shares awarded | Weighted average exercise price (in £) |
|---|---|---|
| Outstanding as at 1 January 2012 | 381,452 | – |
| Granted during the year | 531,071 | – |
| Forfeited during the year | (63,181) | – |
| **Outstanding as at 31 December 2012** | **849,342** | **–** |

*Restricted stock award*
During the prior year, the Company granted 112,654 shares to an employee of an affiliated undertaking as a restricted stock award of which 50% vested on 3 September 2012. The remaining 50% will vest on 3 September 2013 subject to continued employment.

*Employee ShareMatch Plan*
The Company made its first invitation under its Employee ShareMatch Plan in May 2012, for employees of its affiliated undertakings. The Plan includes one free share for every four shares purchased in the market, deliverable on the first anniversary of purchase.

As at 31 December 2012, there were 43,982 shares (2011: nil) outstanding, as free matching shares, under the Employee ShareMatch Plan all of which are expected to vest in May 2013.

## 9. Amounts owed to affiliated undertakings

| Due in one year or less | 2012 US$m | 2011 US$m |
|---|---|---|
| Owed to AZ Electronic Materials (Luxembourg) S.à r.l. | **2.8** | 3.8 |
| **Total** | **2.8** | 3.8 |

The amounts owed to affiliated undertakings are non-interest bearing trading balances due in less than one year. The Group manages its treasury operations on a group basis and therefore the Directors are confident that the Company will have sufficient funds available to meet its debts as they fall due.

## 10. Guarantees

The borrowings of an affiliated undertaking are secured by guarantees granted by certain material Group companies including AZ Electronic Materials S.A.. Guarantor tests apply whereby this group of companies must represent aggregate EBITDA and gross assets, which are greater than 80% of the total AZ Electronic Materials S.A. Group.

## 11. Contingent liabilities

The Company is the employer of an Employees Share Ownership Plan Trust ("ESOP Trust"). The objective of the ESOP Trust is to hold shares purchased in the open market to satisfy the future vesting of shares under the share incentive plans made available to the employees of the Company and its subsidiaries. In so far as the Company's shares held by the ESOP Trust are not included within the total assets of the Company, no allocation to a non-distributable reserve is deemed necessary.

The net assets of the ESOP Trust as at 31 December 2012 amount to US$7.3m of which US$7.1m is represented in the form of 1,269,114 Ordinary shares held in the Company.

## 12. Other operating charges

| | 2012 US$m | 2011 US$m |
|---|---|---|
| Other administration costs | **4.7** | 1.7 |
| Charges from affiliated undertakings | **1.4** | – |
| Provision for share options | **1.7** | 0.5 |
| | **7.8** | 2.2 |

## 13. Other operating income

| | 2012 US$m | 2011 US$m |
|---|---|---|
| **Charges to affiliated undertakings** | **2.0** | **1.0** |

## 14. Emoluments granted to the members of the management and supervisory bodies

Emoluments granted to the members of the management and supervisory bodies are disclosed in full in the consolidated accounts for AZ Electronic Materials S.A.

# Selected historical financial information

The selected audited combined and consolidated historical information for the Group set forth below for the years ended 31 December 2008 to 2012, has been extracted without material adjustment from the Group's audited statutory financial statements which were prepared in accordance with IFRS adopted by the European Union.

## Revenue

| | 2008 US$m | 2009 US$m | 2010 US$m | 2011 US$m | **2012 US$m** |
|---|---|---|---|---|---|
| IC Niche | 225.1 | 184.3 | 266.4 | 352.1 | **356.0** |
| IC Conventional | 184.2 | 145.5 | 182.2 | 193.0 | **181.2** |
| **Total IC Materials revenue** | 409.3 | 329.8 | 448.6 | 545.1 | **537.2** |
| FPD Photoresist | 136.3 | 117.0 | 158.9 | 177.2 | **188.0** |
| Optronics Other | 41.3 | 27.7 | 48.5 | 46.9 | **48.9** |
| **Total Optronics revenue** | 177.6 | 144.7 | 207.4 | 224.1 | **236.9** |
| **Total Printing and Other revenue** | 37.9 | 25.8 | 26.1 | 22.6 | **19.8** |
| **Total revenue** | 624.8 | 500.3 | 682.1 | 791.8 | **793.9** |

## Investment

| | 2008 US$m | 2009 US$m | 2010 US$m | 2011 US$m | **2012 US$m** |
|---|---|---|---|---|---|
| **Research and development costs** | 38.6 | 34.3 | 42.0 | 54.0 | **55.8** |
| **Capital expenditure*** | 38.6 | 10.1 | 32.6 | 50.5 | **50.7** |

* Capital expenditure is defined as additions to property, plant and equipment and intangible assets from the Group's balance sheets, which differs from purchases of property, plant and equipment from the Group's cash flow statements because of the timing of payments.

## EBITDA

| | 2008 US$m | 2009 US$m | 2010 US$m | 2011 US$m | **2012 US$m** |
|---|---|---|---|---|---|
| **EBITDA*** | 185.3 | 144.3 | 225.6 | 261.0 | **262.4** |
| Depreciation | (20.5) | (21.5) | (21.4) | (28.0) | **(29.1)** |
| EBITA | 164.8 | 122.8 | 204.2 | 233.0 | **233.3** |
| Amortisation of intangible assets | (73.0) | (75.1) | (76.8) | (82.3) | **(82.6)** |
| Monitoring fees | (1.6) | (1.6) | (1.5) | – | **–** |
| Exceptional items: | | | | | |
| – Transaction costs | (6.9) | (1.0) | (16.4) | – | **–** |
| – Restructuring costs | (3.2) | (3.1) | (0.6) | – | **–** |
| – Impairment of goodwill | (311.5) | – | – | – | **–** |
| – Impairment of intangible assets | (19.2) | – | – | – | **–** |
| – Reversal of impairment of intangible assets | – | – | 15.4 | – | **–** |
| – Loss on disposal of business | (39.0) | – | – | – | **–** |
| **Operating profit/(loss)** | (289.6) | 42.0 | 124.3 | 150.7 | **150.7** |

* EBITDA is defined as operating profit before depreciation on property, plant and equipment and amortisation of intangible assets. For the years 2008 to 2010 EBITDA was further adjusted for exceptional items and monitoring fees. There were no exceptional items or monitoring fees impacting EBITDA during 2011 and 2012. The requirement to pay monitoring fees to AZ's previous shareholders ceased on 3 November 2010.

## Operating cash flow

| | 2008 US$m | 2009 US$m | 2010 US$m | 2011 US$m | **2012 US$m** |
|---|---|---|---|---|---|
| EBITDA | 185.3 | 144.3 | 225.6 | 261.0 | **262.4** |
| Changes in working capital excluding one-off costs | (18.7) | (4.7) | (0.2) | (5.2) | **(8.8)** |
| Share-based payments charge | – | – | – | – | **1.9** |
| Cash payments for property, plant and equipment and intangible fixed assets | (40.1) | (19.8) | (25.4) | (49.5) | **(51.1)** |
| **Operating cash flow**** | 126.5 | 119.8 | 200.0 | 206.3 | **204.4** |

** Operating cash flow is defined as EBITDA less any changes in working capital (excluding those relating to transaction costs), less net cash payments in relation to capital expenditure and, in respect of 2012, after adding back charges relating to share-based payments.

# Glossary of technical terms

**The following definitions apply throughout this Annual Report & Accounts unless the context requires otherwise:**

| | |
|---|---|
| "ARC" or "Antireflective coating" | Means a layer of material deposited on a wafer either on top or below the resist in order to reduce thin film interference effects; |
| "BARC" or "bottom ARC" | Means an absorbing spin-on organic polymer formulation applied to the bottom of a photoresist to reduce scattering of light and thin film interference effects; |
| "block copolymers" | Means a linear copolymer in which identical mer units are grouped in blocks along the length of the molecular chain; |
| "buffer coating" | Means a product used in the IC industry to protect circuits from external damage; |
| "CMP" or "chemical mechanical planarisation" | Means the chemical and mechanical smoothing of dielectric layers of semiconductors, in order to ensure a uniform plane surface; |
| "CMP slurry" | Means a viscous liquid with a high solids content used in the CMP of a wafer in order to ensure a uniform plane surface; |
| "colloidal silica CMP slurries" | Means a colloidal silica form of CMP slurry, as opposed to fumed silica technology. The Group's colloidal silica slurries are sold under the Klebosol® brand; |
| "copolymers" | Means a chemical compound of high molecular weight formed by uniting the molecules of two or more different compounds (monomers); |
| "COPQ" | Means cost of poor quality; |
| "CVD" or "chemical vapour deposition" | Means a chemical process often used in semiconductor chip manufacturing for the deposition of thin films of various materials; |
| "developer" | Means a product used to remove the photoresist from the substrate after exposure to light; |
| "dielectric" | Means a non-conductive material or insulator; |
| "DSA" or "directed self-assembly" | Means an alternative lithographic technology that enables frequency multiplication through the use of block copolymers; |
| "EBR" or edge bead remover" | Means a solvent mix used in both FPD and IC industries to remove photoresist at the substrate edge; |
| "edge bead" | Means the residual resist that remains on the edge of a substrate after the application process; |
| "etching" | Means the process of using a solution, a mixture of solutions, or a mixture of gases or ions that attacks the surfaces of a film or substrate, removing materials either selectively or non- selectively; |
| "EUV/EUVL" or "extreme ultra-violet lithography" | Means a next generation lithography technology using an extreme ultra-violet wavelength; |
| "film" | Means a thin layer of material adhering to a surface; |
| "FIRM®" | Means a type of rinse material proprietary to the Group used to prevent defects and the collapse of stacks of silicon wafers; |
| "FPD" or "flat panel display" | Means a thin, lightweight video display used in laptop, televisions, mobile phones and notebook computers which employs liquid crystals, electroluminescence or a similar alternative to cathode-ray tubes; |
| "Graphene" | Means a super conductive form of carbon, made from single-atom-thick sheet and alongside carbon nanotubes these materials are an area of increasing interest within the electronics industry as a result of its characteristics which include conductivity, flexibility, strength, lightweight and transparency; |
| "IC" or "integrated circuit" | Means a fabrication technology that combines most of the components of a circuit on one semiconductor substrate, such as a single-crystal silicon wafer; |
| "ITRS" or International Technology Roadmap for Semiconductors" | Means the roadmap or technology assessment of the needs and challenges facing the semiconductor industry over the next 15 years; |
| "LCD" or "liquid crystal display" | Means a low-power flat-panel display used in many laptop computers, televisions and electronic devices, made up of a liquid crystal that is sandwiched between layers of glass or plastic that becomes opaque when an electric field is applied. The contrast between the opaque and transparent areas forms visible images; |
| "LED" or "light emitting diode" | Means a semiconductor diode that produces visible or infrared light when subjected to an electric current, as a result of electroluminescence; |
| "lithography" | Means a process in which a masked pattern is projected onto a photosensitive coating that covers a substrate and then developed to yield a relief image; |
| "miniaturisation" | Means the trend towards decreasing sizes of semiconductor chips enabled by technologies that facilitate narrower line widths and reduced feature sizes; |
| "Moore's Law" | Describes the industry impetus to fit more functionality in a semiconductor device and states that the number of transistors on an IC will double approximately every two years; |
| "Novolak" | Means polycondensate resin made from phenolic monomers. One of the Group's higher volume raw materials mostly used in FPD and IC photoresists; |

| | |
|---|---|
| "OLED" or "organic LED" | Means a LED in which the emissive electroluminescent layer is a film of organic compounds that emits light when an electric current passes through it. This technology is still in the development phase and is used mostly in small screens for mobile phones, MP3 players, car radios and digital cameras; |
| "PAC or PACs" | Means organic photoactive compounds, which are used in the production of photoresists; |
| "patterning" | Means a process of photolithography of forming geometrical shapes by the use of photosensitive resists, masks and etching techniques; |
| "PC" | Means personal computer; |
| "PFOS" or "perfluorooctanesulfonic" acid | Means an acid used in the photolithography process; |
| "PGMEA" or "Propylene Glycol Methyl Ether Acetate" | Means an oil-based solvent used in the manufacture of photoresists and EBRs primarily for use in the manufacture of IC materials; |
| "photomask" or "mask" | Means a structure comprising functional pattern images produced on a film, plastic, or glass-based material and accurately positioned so as to be useful for selective exposure of a photoresist coating; |
| "photoresist" | Means a light-sensitive substance used to facilitate the transfer of glass substrate materials in FPDs and on semiconductor wafers in ICs; |
| "PHPS" or perhydropolysilazane" | Means a novel spin-on dielectric (insulation layer) used in semiconductor chips. PHPS is rapidly replacing the existing CVD products, given its lower cost and superior performance characteristics; |
| "pixel" | Means the basic unit of programmable colour on a computer display or in a computer image; |
| "RELACS®" | Means licensed shrink technology, used in the IC industry that enables feature sizes to be significantly reduced whilst still using existing lithography equipment. The terms RELACs® stands for Resolution Enhancement Lithography Assisted by Chemical Shrink; |
| "resist" | Means a photosensitive liquid-plastic film applied to the surface of a substrate for lithography; |
| "SAP" | Means System Applications & Products; |
| "SEMATECH" | Means the Semiconductor Manufacturing Technology Industry Association; |
| "SELETE" | Means Semiconductor Leading Edge Technologies, a consortium for the development of silicon wafer technologies; |
| "semiconductor" | Means an element that has an electrical resistivity in the range between conductors (such as aluminium) and insulators (such as silicon dioxide). ICs are typically fabricated in semiconductor materials such as silicon, germanium, or gallium arsenide; |
| "SI" or "silicon" | Means a silverish crystalline semimetal used to make the majority of semiconductor wafers; |
| "Si-Tech" | Means the application of silicon chemistry to aide solutions to technological challenges; |
| "Spinfil"® | Means the brand name under which the Group markets PHPS of two types used as a general dielectric; |
| "stripper" | Means a chemical solvent or agent used to remove residual photoresist from a silicon wafer after etching; |
| "substrate" | Means a substance that is the basis for subsequent processing operations in the fabrication of semiconductor devices or circuits or FPDs; |
| "TARC" or "top ARC" | Means a water soluble layer applied to the top of a photoresist in order to reduce thin film interference; |
| "TFR" or "thick film resist" | Means a resist used in the IC industry to connect semiconductor chips to a circuit board and for recording hard disk drives; |
| "TFT" or "thin film transistor" | Means a special kind of field-effect transistor made by depositing thin films of a semiconductor active layer as well as the dielectric layer and metallic contacts over a supporting substrate; |
| "UV" | Means ultra violet; |
| "wafer" | Means a thin slice with parallel faces cut from a semiconductor crystal; and |
| "wafer start" | Means a measure of the volume of silicon substrate used in semiconductor manufacturing processes. Wafer starts are used to show fabrication design capacity/output. |

# Shareholder information

## Share register analysis as at 18 February 2013

| Holding range: | Number of Holders* | % | Number of Ordinary shares | % |
|---|---|---|---|---|
| 1 – 1,000 | 74 | 11.61 | 42,052 | 0.01 |
| 1,001 – 5,000 | 134 | 21.04 | 356,114 | 0.09 |
| 5,001 – 10,000 | 37 | 5.81 | 273,023 | 0.07 |
| 10,001 – 50,000 | 80 | 12.56 | 2,122,774 | 0.56 |
| 50,001 – 100,000 | 57 | 8.95 | 4,071,446 | 1.07 |
| 100,001 – 500,000 | 128 | 20.09 | 29,727,117 | 7.81 |
| 500,001 – upwards | 127 | 19.94 | 344,321,026 | 90.39 |
| **Total** | | **100.00** | **380,913,552** | **100.00** |

| Held by: | Number of Holders* | % | Number of Ordinary shares | % |
|---|---|---|---|---|
| Private shareholders | 77 | 12.09 | 1,521,107 | 0.40 |
| Institutions and companies | 560 | 87.91 | 379,392,445 | 99.60 |
| **Total** | | **100.00** | **380,913,552** | **100.00** |

* Including Shareholders and Depository Interest holders

## Ordinary Shares

The Company's Ordinary shares (each of nominal value US$0.10) are traded on the main market for listed securities on the London Stock Exchange (Ticker: AZEM; SIN reference: LU0552383324; SEDOL number: B63H009).

## Annual General Meeting

The Company's 2013 Annual General Meeting will be held at 12 noon (CET) on Wednesday, 24 April 2013 at the Company's registered office at 32-36 Boulevard d'Avranches, L-1160 Luxembourg. Full details are given in the Notice of Annual General Meeting which accompanies this Annual Report.

## Company Website – www.azem.com

The Company's Annual and Interim Reports, results announcements and presentations are available to view and download from the Company's website. The website also shows the current AZ share price information, the latest news about the Company, its products and operations and how to obtain further information.

The Directors are responsible for the maintenance and integrity of the Company's website. Financial information published on the website is based on legislation in the UK governing the preparation and dissemination of financial statements that may be different from comparable legislation in other jurisdictions.

### Company's Registrar – Capita Registrars
Enquiries concerning shareholdings, dividends and changes in personal details should be referred to Capita Registrars ("Capita") in the first instance. They can be contacted at ssd@capitaregistrars.com or otherwise as follows:

Tel: 0871 664 0300 (calls cost 10 pence per minute plus network extras) or +44 (0) 20 8639 3399 (from outside the UK). Lines are open from 09:00 to 17:30, Monday to Friday, excluding public holidays.

### www.capitaregistrars.co.uk
Shareholders can view and manage their shareholding through the AZ share portal which is hosted by Capita – simply log on to www.capitashareportal.com and follow the registration instructions.

### Depository Interests
Capita IRG Trustees Limited acts as the Depository for the dematerialised depository interests representing the underlying Ordinary shares which are held on trust for the holders of the depository interests. If you wish to contact the Depository please do so in writing to Capita IRG Trustees Limited, Regulated Business, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU, England or email custodymgt@capitaregistrars.com.

### Shareholder Enquiries
If you have an enquiry about the Company's business or about something affecting you as a Shareholder or Depository Interest holder (other than queries which are dealt with by Capita), please email the Company Secretary at company.secretary@azem.com.

### Share Dealing Services
The Company's shares can be traded through most banks, building societies and stockbrokers. Additionally, Capita offers an online and telephone share dealing service for EEA resident shareholders through Capita IRG Trustees Limited. To use this service, shareholders should contact Capita: 0871 664 0445 from the UK (calls cost 10 pence per minute plus network charges). Lines are open Monday to Friday 08:00 to 16:30 (www.capitadeal.com).

### 2012 Final Dividend – see timetable on page 129
On 18 February 2013, the Directors recommended a final dividend of 9.1 cents per Ordinary share which, subject to shareholder approval at the Annual General Meeting on 24 April, will be paid on 3 May to shareholders on the statutory register on 15 March 2013.

The final dividend will be paid without deduction of Luxembourg withholding tax in GB Pounds Sterling ("GB£") unless a currency election is made to receive the dividend in US$. The US$:GB£ exchange rate to be used will be that prevailing on or about 15 April and will be notified by means of a public announcement to the London Stock Exchange on 16 April 2013.

**The tax outcomes of receiving a dividend from the Company will depend on the specific circumstances of Shareholders and Depository Interest holders.**

**If you are in any doubt as to what action you should take, you should consult an appropriately qualified professional adviser.**

**To be valid for the 2012 Final Dividend, all completed election and/or application forms must be received by Capita on or before the 8 April 2013 closing date.**

Depository Interest holders who wish to make a currency election should either reference their CREST Manual (if they are CREST participants) or contact their CREST sponsor who will be able to take the appropriate action on their behalf.

# Shareholder information continued

- Dividend payments to UK shareholders – Dividend Mandates

  AZ recommends that dividends are paid direct into a nominated bank or building society account through the Bankers Automated Clearing System ("BACS"). This service provides cleared funds on the dividend payment date, is more secure than sending a cheque by post and avoids the inconvenience of paying each dividend by cheque. This arrangement is only available in respect of dividends paid in GB£.

- Dividend payments to overseas' shareholders – International Payment Service

  For international shareholders who would prefer to receive payment of their dividends in local currency and direct into their local bank account, an Internal Payment Service ("IPS") is available. This can be more convenient and effective than your otherwise receiving dividend payments by GB£ cheque or into a UK bank account.

  The IPS service is available from Capita who, in partnership with Western Union, may be able to convert GB£ dividends into your local currency at competitive rates and either arrange for those funds to be sent to you by currency draft or credited to your bank account directly.

- Dividend Reinvestment Plan ("DRIP")

  A DRIP is available from Capita IRG Trustees Limited. This facility provides an opportunity by which Shareholders can conveniently and easily increase their holding in the Company by using their cash dividends to buy more shares.

  Participation in the DRIP will mean that your dividend payments will be reinvested in AZ shares and these will be purchased on your behalf in the market on, or as soon as practical after, the dividend payment date.

  You may only participate in the DRIP provided that you are resident in the EEA, Channel Islands or Isle of Man.

For further information on, and to register for, any of these dividend-related services, simply log on to www.capitashareportal.com.

**Identity Theft**
Tips for protecting your AZ shares:

- Ensure all your certificates are kept in a safe place or hold your shares electronically in CREST.
- Keep all correspondence from Capita in a safe place, or destroy correspondence by shredding.
- If you change address, inform Capita in writing or via the Shareholder Portal. If you receive a letter from Capita regarding a change of address but have not recently moved, please contact them immediately.
- Consider having your dividend paid directly into your bank account. This will reduce the risk of the cheque being intercepted or lost in the post.
- If you change your bank account, inform Capita of the details of your new account. You can do this via post or online using the Shareholder Portal.
- If you are buying or selling shares, only deal with brokers registered in your country of residence or the UK.
- Respond to any letters Capita sends you about this.

# Financial calendar 2013

## Financial calendar 2013 (including 2012 Final Dividend timetable)

| | 2013 |
|---|---|
| Ex-Dividend Date | 13 March |
| Record Date | 15 March |
| Deadline for currency elections, IPS mandates, dividend mandates and DRIP elections | 8 April |
| Exchange rate announced for GB£ default payment | 16 April |
| Annual General Meeting | 24 April |
| Interim Management Statement | 25 April |
| Payment Date | 3 May |
| Half-Year Results Announcement | 15 August |
| Interim Management Statement | 24 October |
| Financial Year-End | 31 December |
| | **2014** |
| Full-Year Preliminary Results Announcement (provisional) | February |

Notes:
The 2012 Final Dividend will be paid by the Company without deduction of Luxembourg withholding tax.

The tax outcomes of receiving a dividend from the Company will depend on the specific circumstances of Shareholders and Depository Interest holders. If you are in any doubt as to what action you should take, you should consult an appropriately qualified professional advisor.

# Contact details and advisers

## Registered Office and Number

**AZ Electronic Materials S.A.**
32-36, Boulevard d'Avranches,
L-1160 Luxembourg

RCS Luxembourg: B156074

Tel: +352 26 49 79 1116
Fax: +352 26 49 79 8888
www.azem.com

## Company Secretary

**Michael Arnaouti, FCIS**
michael.arnaouti@azem.com

## UK Correspondence Address

**AZ Electronic Materials Services Limited**
Lakeside House
1 Furzeground Way
Stockley Park East
Middlesex UB11 1BD
England

Tel: +44 (0) 2086 223 385
Fax: +44 (0) 2086 223 159
Email: company.secretary@azem.com

## Share Registrar (Shareholders)

**Capita Registrars (Jersey) Limited**
12 Castle Street
St Helier
Jersey JE2 3RT
Channel Islands

Tel: 0871 664 0300
(calls cost 10 pence per minute
plus network extras)

Tel: +44 (0) 20 8639 3399
(from outside the UK)

Lines are open from 09:00 to 17:30,
Monday to Friday, excluding public holidays

Email: ssd@capitaregistrars.com
www.capitaregistrars.com

## Depository Interest Registrar (Depository Interest holders)

**Capital IRG Trustees Limited**
Regulated Business
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
England

Email: custodymgt@capitaregistrars.com

## Auditor

**Deloitte Audit,**
**Société à responsabilité limitée**
560 rue de Neudorf
L-2220 Luxembourg

*Réviseur d'entreprises agréé*
Grand Duchy of Luxembourg

Tel : +352 451 451
www.deloitte.lu

## Joint Brokers

**UBS Investment Bank**
1-2 Finsbury Avenue
London EC2M 2PP
England

Tel: +44 (0) 207 567 8000
www.ubs.com

**Goldman Sachs International**
Peterborough Court
133 Fleet Street
London EC4A 2BB
England

Tel: +44 (0) 207 552 1000
www.gs.com

## Bankers

**HSBC Bank PLC**
**Mizuho Corporate Bank, Ltd.**

## Legal Advisers

**Clifford Chance LLP**
**Eversheds LLP**

## Financial PR Consultants

**FTI Consulting Limited**

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Nick Veasey

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AZ Electronic Materials S.A. is a public limited liability company (Société Anonyme) incorporated under the laws of the Grand Duchy of Luxembourg and registered with the Luxembourg Register of Commerce and Companies under number B156074.

The Company's Ordinary shares (each of nominal value US$0.10) were admitted to the premium listing segment of the Official List of the UK Listing Authority and to unconditional trading on the London Stock Exchange's main market for listed securities on 3 November 2010 (Ticker: AZEM; SIN reference: LU0552383324 and SEDOL number B63H009). The Company is a constituent member of the FTSE 250 index.

For the purposes of this Annual Report, "Company" means AZ Electronic Materials S.A. and "Group" or "AZ" means the Company and its subsidiary undertakings.

This is the Annual Report of AZ Electronic Materials S.A. for the 12-month period ended 31 December 2012 and complies with Luxembourg legislation and regulations. It is also available on the Company's website at www.azem.com.



**Use of Third-Party Information**

Certain information contained in this Annual Report, relating to the IC, FPD and other industries in which AZ operates as well as certain economic and industry data and forecasts used in, and statements regarding AZ's market position made in, this Annual Report were extracted or derived from third party reports, market research, government and other publicly available information and independent industry publications, as the case may be, prepared by, inter alia, DisplaySearch LLC ("DisplaySearch"), Gartner, Inc. ("Gartner"), World Semiconductor Trade Statistics, Inc. ("WSTS"), Semiconductor International Capacity Statistics ("SICAS"), DRAMeXchange Inc. ("DRAMeXchange") and VLSI Research, Inc. ("VLSI Research"), and were also extracted from a report commissioned and prepared for AZ by Nexant, Ltd ("Nexant"). Any source attributable to Gartner in this Annual Report represents data, research opinions or viewpoints published, as part of a syndicated subscription service, by Gartner and are not representations of fact. Each Gartner report speaks as of its original publication date (and not as of the date of this Annual Report) and the opinions expressed in the Gartner reports are subject to change without notice.

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**Cautionary Statement**

The purpose of this Annual Report is to provide information to the members of the Company. The Annual Report contains certain forward-looking statements with respect to the operations, performance and financial condition of the Group. These statements are made in good faith and are based on current expectations or beliefs, as well as assumptions about future events. By their nature, future events and circumstances can cause results and developments to differ materially from those anticipated. No undertaking is given to update the forward-looking statements contained in this Annual Report, whether as a result of new information, future events or otherwise. Nothing in this Annual Report should be construed as a profit forecast or an invitation to deal in Ordinary shares of AZ Electronic Materials S.A.

ELECTRONIC MATERIALS

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