

Chief executive officer's review

Ras Myburgh



Introduction

Kumba's first full year as a pure-play iron ore business and as a listed group was marked by record production of 32.4Mt, a strong financial performance with operating profit up 52% year on year (before the effect of once-off items) and a 156% increase in our share price. There were many milestones in the 12 months to 31 December 2007, perhaps the most important of these being first production from the 13Mtpa Sishen Expansion Project jig plants. Commendably, Sishen Mine's unit cost was contained despite inflationary pressures and increased activity and, accordingly, the group's operating margin rose from 45% to 52%.

Kumba's 33% increase in revenue reflects not only record production, but higher sales volumes, increased benchmark prices and quality premia on certain products.

Iron ore is a critical input of the global steel industry. As such, the seaborne market for iron ore has grown at a compound annual rate of 8.1% from 454Mtpa in 2000 to 782Mtpa in 2007, primarily because of demand growth in China. Consensus expectations are that China will continue being the main driver of global steel production growth, with current forecasts suggesting that China will increase production from 420Mtpa in 2006 to 750Mtpa by 2012, requiring iron ore imports of over 730Mtpa.

The rise in maintenance-related activities and external contractor mining as a result of increasing mining activities at Sishen Mine affected the cost of production for the period. While we are satisfied that unit cost increases at the mine were contained to 2.5% for the year, maintaining this level will be more challenging given the inflationary pressures affecting the broader mining industry.

Equally, South Africa's power shortages have adversely affected Kumba's operations. Given that a 10% reduction in electricity use is required nationally to restore integrity of the energy supply, we have taken a number of steps to achieve this target, including a decision to cease all electricity power-assisted trucking (pantograph system) in the short term.

Our group's use of diesel will, therefore, increase and the efficiencies of the pantograph systems will be lost while the power reduction continues. Consequently, a rise in unit costs is likely and a reduction in output is possible if the crisis deepens.

Safety

Caring for our people, our environment and communities where we operate is part of the value system of Kumba.

In our commitment to safety and as a member of the Anglo America plc group (AA plc) we take our lead from its chief executive officer, Cynthia Carroll. Like her, Kumba is passionate about safety. We also believe that it is simply unacceptable for any of our employees to be injured in any way. On the road to safety maturity and in our quest for zero harm we continued to improve our safety performance over the year and safety will remain a top priority.

Sishen Mine maintained its lost-time injury frequency rate (LTIFR) at 0.23, achieving four separate periods of three to four million man-hours without a lost-time injury. The Sishen Expansion Project achieved an LTIFR of 0.24 at the end of December 2007.

Most commendably, by year end, Thabazimbi Mine had worked for more than five years without a fatality and recorded only two lost-time injuries in 2007.

Regrettably we had one fatality in February 2007, and we extend our deepest condolences to the family, friends and colleagues of Mr Samuel Marutle who died in a heavy vehicle incident.

Numerous safety initiatives (p74) are under way to improve awareness and performance in this area, focused on:

- Risk and change management – with a strong focus on principal hazards such as contractor management, lifting and material handling, transport management and implementation of group-wide fatal risk standards
- Culture, leadership and communication
- Training and competency
- Empowerment of first-line management.

Our first year as a pure-play iron ore business saw several records broken, most notably a production high of 32.4Mt and the first output from our R5 billion Sishen Expansion Project, which contributes significantly to skills development in the Northern Cape.

Our renewed safety improvement plans will be rolled out over three years and their success relies heavily on the support of every leader, employee and contractor in our group.

People

Kumba has a strong base of competent people, characterised by a positive attitude. Retaining these skills, attracting new skills and building a pool of talent for the future are our focus areas. Acknowledging the shortage of talent, especially scarce technical skills in disciplines such as engineering and geology, we have a comprehensive plan in place to ensure we have the skills to deal with our challenges (p70). We are committed to personal development and almost 600 young people are currently involved in some form of Kumba training, learnerships or bursaries. The group spends over 5% of payroll on skills development – well above the national average of some 3%.

We had good responses to employee wellness and awareness campaigns during the year. Over 75% of employees participated in the 2007 voluntary counselling and testing for HIV/Aids, and 92 employees are enrolled on the antiretroviral treatment programme, while some 300 are on the wellness programme. The success of these initiatives is partly reflected in a prevalence rate that has dropped to 6% from 11% in 2004. In December 2007, we also opened the first privately sponsored HIV and Aids treatment clinic in the Northern Cape in partnership with the local municipality and provincial department of health. This wellness clinic will provide services to the entire community, complementing current local private and public health services.

To effectively manage our expansions and the re-allocation of responsibilities, the executive team was strengthened during the year by the appointment of Timo Smit as head of commercial, Francois Louw as head of projects and Tebello Chabana as head of public affairs.

Transformation

Transformation is under way at many levels within Kumba.

During the year, we held a workshop with the Department of Minerals and Energy to verify our black economic empowerment shareholding of 26%. We await the department's confirmation of our ownership status.

We met our internal preferential procurement target of 30% (p63) and remain committed to continual improvement in this area, aided by supplier development programmes.

Employees are now shareholders in the group (p90) and we continue to make progress in building a representative workforce (p72).

Strategic aspirations and focus

Kumba's business planning process crystallises targets and responsibilities across our operations and business units, culminating in group goals:

- We have demanding aspirations for **safety** performance goals; we know these can only be reached through leadership, systems and procedures and by demonstrating our values in every action and decision to create a culture that will continually influence safe behaviour.
- To reach our goal of **maximising revenue**, we need to enhance credibility further by achieving our volume commitments, and demonstrate our marketing expertise by achieving quality premia for our niche products.
- **Business improvement** will be another priority area for the year, focused on rolling out value-based management, refining asset management and reducing costs of production and corporate costs.
- We will also focus on **value growth**, primarily by resolving the challenges of expansion and cost around the export channel and securing new-order rights for Sishen South.
- **Longer-term value growth** issues such as the Northern Cape growth pipeline, opportunities outside South Africa and adding value to our products and customers will also receive attention.

Operational performance

Kumba's first year culminated in good production results, even though our key expansion project was not yet fully operational. Tonnes produced set a new record of 32.4 million and the increase in unit costs was restricted to under 2.5% despite our current expansionary phase.

Sishen Mine achieved record production of 29.3Mt from the dense medium separation plant for 2007 and other production initiatives added 200,000 tonnes. Production from the newly operational jig plant contributed 173,000 tonnes although this was significantly lower than expected due to delays in commissioning the project. The 15% increase in total tonnes mined to 104.4Mt reflects higher mining activity because of the increased pit size and additional run-of-mine production in preparation for the expansion. This run-of-mine production includes 9.3Mt of B-grade material stockpiled as feedstock for the jig plant.

Thabazimbi Mine sustained production and sales were in line with ArcelorMittal's requirements. The life-of-mine has been extended to 2014 by including reserves now considered economical to mine given the change in iron ore prices.

Project pipeline and growth

Kumba's immediate plan is to double export capacity by 2013 to just over 45Mt. The first product from the 13Mt Sishen Expansion Project jig plant has already been shipped to customers, and we expect 8Mt in 2008 and 13Mt in 2009 from the jig plant. Some 400,000tpa will be added to this phase of Sishen Mine expansion in 2010 with the installation of a fines beneficiation circuit in the Sishen Expansion Project.

The next significant expansion is 9Mt/tpa from Sishen South with first production anticipated in 2012. When domestic sales of some 9Mt/tpa are added, Kumba will exceed production capacity of 50Mt/tpa by 2013.

These Northern Cape projects, however, depend on economically competitive expansions of the Sishen-Saldanha export channel. Kumba is actively engaged in discussions with state-owned utility, Transnet, which owns and operates the logistical infrastructure, and other industry participants in developing economically viable long-term solutions.

Sishen Expansion Project (SEP) jig plant: By end 2007, four of the eight jig modules were successfully commissioned and two of the four tertiary crushers brought into production. The primary and secondary crushers were successfully commissioned in late January 2008. Plant commissioning was affected by the late delivery of the primary and secondary crushers and delays due to a shortage of skills and resources caused by constraints in the construction industry.

Sishen South Project: This project involves developing a new opencast operation some 80km south of Sishen Mine and is currently being considered for development. However, this decision primarily depends on finalising commercial arrangements for the expansion of the Sishen-Saldanha export channel and mining rights being granted. Certain orders for long-lead items have been placed and product acceptance through letters from customers has been obtained. The Sishen South feasibility study was completed according to plan and cost estimates refined.

SEP II: A pre-feasibility study to increase production at Sishen Mine by 5-10Mt/tpa in addition to the jig plant is due to be completed in 2008. An evaluation of the product strategy of the mine is part of the pre-feasibility study to ensure it is aligned with future market developments as well as the mining resource and production facilities at the operation.

Beyond SEP and Sishen South

Our project pipeline is healthy and balanced, with projects in the Northern Cape, elsewhere in South Africa and in Africa offering the potential to grow towards 70Mtpa and beyond. This pipeline is constantly reviewed to consider operating and market conditions.

Guinea

In Guinea, Kumba owns a controlling stake in a company that has an exploration project some 300km north of the capital Conakry. Exploratory drilling began in April 2008 which could lead to the development of an iron ore mine as part of our growth strategy in West Africa.

IMBS

Kumba also entered into a venture with Jonah Capital's Iron Mineral Beneficiation Services (IMBS) to convert superfine iron ore tailings – currently considered waste – into metallic iron using ground-breaking technology. The venture is funded by the Industrial Development Corporation of South Africa (IDC) and offers the potential to transform large tonnages of superfine ore lying on tailings dumps into saleable product.

Legal proceedings

Falémé

Kumba has initiated arbitration proceedings against La Societe Des Mines De Fer Du Senegal Oriental (Miferso) and the Republic of Senegal under the rules of arbitration of the International Chamber of Commerce. This process is confidential and further disclosure will only be made once the final outcome is known.

ArcelorMittal

Kumba and ArcelorMittal have agreed to an arbitration process to resolve key differences of interpretation of the Sishen supply agreement. Arbitration proceedings were initiated in 2007 by Kumba. These proceedings are confidential and further disclosure will only be made once the final outcome is known.

Sustainability

Sustainability is a key element of all we do. We know Kumba's continued existence must contribute to economic and social development and environmental preservation – at local, provincial and national levels. To ensure that our sustainable development programmes are truly effective we align them with national priorities and initiatives.

Based on internationally recognised practices, our sustainable development report (from p60) sets out our progress in weaving sustainability into the fabric of our business.

Prospects

Global economic growth is expected to slow in the year ahead as domestic housing finance problems in the United States affect that country's economic growth and the ripple effect spreads.

However, the global market for iron ore is forecast to remain buoyant in the short to medium term. The economies of China and the rest of Asia are expected to continue growing on the back of strong domestic demand and high levels of domestic fixed investment, providing continued strong growth in demand for iron ore. Major suppliers, however, are still struggling to bring new production in on time to meet rising demand due to the global shortage in engineering and construction resources.

In addition, logistical constraints associated with rail and port capacity and periodic shortages in dry bulk vessel capacity are expected to affect the supply side of the seaborne iron ore market. As a result, prices are expected to remain firm in the medium term.

Operating expenses will remain under pressure, possibly exacerbated by energy shortages and the need to use higher-cost options to maintain production. Production from the jig plant is expected to ramp up in 2008, reaching 13Mt in 2009, with most of this additional production destined for markets in China.

Thanks

It is my privilege to head a team of people that has so convincingly proved its worth in the past year. Just as importantly, as a team we have agreed on the way forward for our group with the full support of a formidable board of directors under the chairmanship of Lazarus Zim. I have every confidence that, together, we will attain all our goals.



Ras Myburgh
Chief executive officer

13 February 2008