

## Financial review

Kumba continued to generate superior returns for shareholders, with significant growth in its share price and a substantial dividend.

### Introduction

This review compares the Kumba group's financial performance for 2007 to 2006 (a pro forma 12-month comparative consolidated income statement for the Kumba group is provided in annexure 3 of the annual financial statements (p178)). The purpose of this review is to provide further insight into the financial performance and position of Kumba as at 31 December 2007.

### Operating results

The key indicators of our operating results during the past year are:

Rand million	2007	2006	% change
Revenue	<b>11,497</b>	8,654	33
Operating expenditure*	<b>(5,519)</b>	(4,719)	(17)
Operating profit*	<b>5,978</b>	3,935	52
Operating margin (%) (EBIT)*	<b>52</b>	45	–
Headline earnings	<b>3,062</b>	2,125	44
Cash from operations	<b>5,805</b>	4,277	36
Capital expenditure	<b>2,119</b>	1,718	23

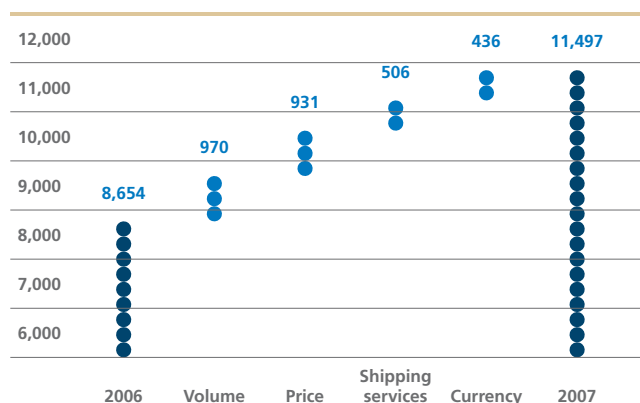
\* 31 December 2006 results have been adjusted for the once-off net surplus on the sale of non-iron ore assets of R1,571 million and share-based payment expense – SIOC Community Development SPV of (R153 million).

### Revenue

Kumba increased revenue by 33% on the back of record production, higher sales volumes, increased benchmark prices and quality premia on certain products.

Revenue generated from the sale of iron ore and the provision of shipping services increased 33% from R8.7 billion to R11.5 billion.

Revenue variance (Rand million)



This increase was principally a result of:

- An increase of 10% in sales volumes from 29.8Mt to 32.9Mt which added R970 million. Export sales volumes from Sishen Mine increased by 12% from 21.5Mt in 2006 to 24.0Mt. Overall sales volumes increased on the back of record production at Sishen Mine and the sale in the first quarter of 2007 of finished product inventory that had built up at the Saldanha port as a result of an equipment breakdown at the port in September 2006. Domestic sales volumes were 7% higher at 8.9Mt due to increased demand from ArcelorMittal.
- The year-on-year weighted average prices from export sale volumes increased by 12% from US\$47.97 per tonne to US\$53.83 per tonne in 2007, which buoyed export revenue by R931 million. Export sales for the first three months of 2007 were based on the 19.0% increase in the iron ore benchmark price for 2006/2007. An increase of 9.5% in the benchmark price for the 2007/2008 iron ore year applied from 1 April 2007, before accounting for quality premia on small volumes.

- Increased revenue from shipping services of R506 million. The 87% rise in shipping revenue from R579 million in 2006 to R1.1 billion in 2007 is principally the result of a 92% increase in the average freight rate per tonne and an increase in volumes shipped on a cost insurance freight (CIF) basis.
- The weakening of the average exchange rate of the Rand to the US Dollar (average spot exchange rates R7.03/US\$1.00 in 2007 compared with R6.73/US\$1.00 in 2006) contributed R436 million to revenue.

## Operating expenditure

Operating expenses remained under pressure with an increase of 17% year on year:

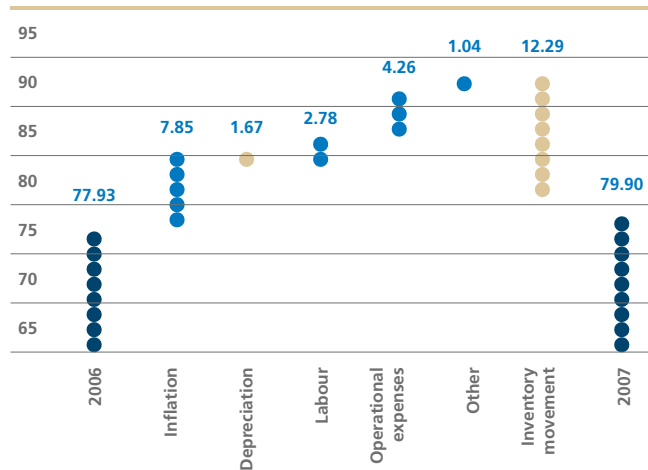
Rand million	2007	2006	% change
Cost of goods sold	3,338	3,094	(8)
Production costs	3,740	3,143	(19)
Inventory movements	(402)	(49)	
Expenditure – shipping services	887	479	(85)
Selling, rail and port costs	1,300	1,151	(13)
Sublease rent received	(6)	(5)	20
<b>Operating expenditure</b>	<b>5,519</b>	<b>4,719</b>	<b>(17)</b>

The cost of goods sold increased 8% from R3.1 billion to R3.3 billion in 2007. The increase in production costs of R597 million was tempered by the rise of R353 million in the movement in inventory balances from one period to the next. During the year approximately 9.3Mt of B-grade material (with an iron content of between 50% and 60%) mined at Sishen Mine with a cost of R440 million was stockpiled ahead of the full commissioning and ramp-up of SEP. Expenditure arising from shipping services increased 85% due to higher average freight rates. A similar increase was achieved in revenue from these operations. Selling, rail and port costs increased 13% year on year due to increases in rail and port tariffs, a higher load factor as the export channel is ramped up for increased volumes from SEP, and an increase in the volumes railed and shipped during 2007.

## Sishen Mine unit cost

Sishen Mine saw record production of 29.7Mt – an increase of 4% from 28.7Mt in 2006. Total tonnes mined at Sishen Mine increased 15% from 90.5Mt in 2006 to 104.5Mt. Inflationary pressures and a rise in maintenance-related activities and external contractor mining as a result of increasing mining activities at the mine affected the cost of production. After taking into account the capitalisation of the costs associated with 9.3Mt of B-grade material, Sishen Mine's unit cost increase of 2.5% was contained at R79.90 per tonne compared to R77.93 per tonne in 2006, despite increased mining activities and inflationary pressures.

## Sishen Mine unit cost (Rand per tonne)



## Operating profit

Although operating expenses remained under pressure, Kumba's operating margin increased from 45% (before once-off items) to 52% in 2007.

## Capital expenditure

Kumba incurred capital expenditure of R2.1 billion in 2007, some R401 million more than the R1.7 billion spent in 2006. This increase was principally incurred on SEP as activities on the project increased during the year – with expansion capital expenditure increasing from R1.4 billion to R1.8 billion.

Aggregate capital expenditure on SEP to 31 December 2007 totalled R3.3 billion, with approximately R1.0 billion expected to be incurred in 2008 and R0.6 billion in 2009.

## Cash flows

Cash flows of R5.8 billion were generated by operations, an increase of 36% on the R4.3 billion generated in 2006.

The cash generated by Kumba was used to pay interest of R300 million, taxation of R1.3 billion and dividends of R1.7 billion (R1.4 billion to shareholders of Kumba and R392 million to minority shareholders of Sishen Iron Ore Company) during the year. Bank facilities were used to fund R2.1 billion of capital expenditure for SEP and to maintain operations. Certain interest-bearing borrowings were repaid with cash flows generated during the year.

Rand million	2007	2006	% change
Cash generated by operations	5,805	4,277	36
Capital expenditure	2,119	1,462	45
Net decrease in debt	(489)	(939)	(48)
Dividends paid	1,745	–	–
Dividends to Kumba shareholders	1,353	–	–
Dividends to minority shareholders	392	–	–

## Net debt

Kumba's net debt position at 31 December was as follows:

Rand million	2007	2006
Long-term interest-bearing borrowings	1,040	2,840
Short-term interest-bearing borrowings	2,490	1,179
Total	3,530	4,019
Cash and cash equivalents	(952)	(1,094)
Net debt	2,578	2,925
Total equity	3,295	1,055

Through strong cash flow generation, the net debt position of Kumba has reduced from R2.9 billion in 2006 to R2.6 billion in 2007.

It is the intention of management to fund Kumba's capital expansion projects through debt financing. At 31 December 2007 Kumba was revolving certain of its debt facilities and, for this reason, a significant portion of the interest-bearing borrowings are considered short term. However, as debt is used to finance Kumba's expansion, the debt profile will return to a longer-term profile. The maximum debt in terms of current covenants is R4.5 billion. Kumba was not in breach of any of its covenants during the year, with interest cover at a healthy 19 times earnings.

## Shareholder returns

Kumba continued to generate a superior return for its shareholders during the year, with significant growth in its share price and a substantial dividend.

## Share price

Calendar 2007 marks the first full year of Kumba as a pure-play iron ore business listed on the main board of the JSE Limited and saw the Kumba share price close at R285 per share, up 156% for the year, creating an increased market capitalisation of R55.5 billion over the period.

### Kumba share price performance (Rand)



## Dividends

Attributable and headline earnings for the year were 985 cents and 974 cents per share respectively, on which a final dividend of 400 cents per share has been declared and an interim dividend of 350 cents per share was paid. This brings the total dividend for the year to 750 cents per share.

Kumba's policy is to pay a dividend to its shareholders twice a year (interim and final), with a goal of reducing the cover to 1 times earnings (inclusive of STC) over the long term. The dividend is determined after taking into account the available cash of Sishen Iron Ore Company.

## Empowerment

As part of the unbundling, Kumba implemented various transactions in which 26% ownership in Sishen Iron Ore Company was transferred to Exxaro Resources (20%), SIOC Community Development SPV (3%) and Envision (3%).

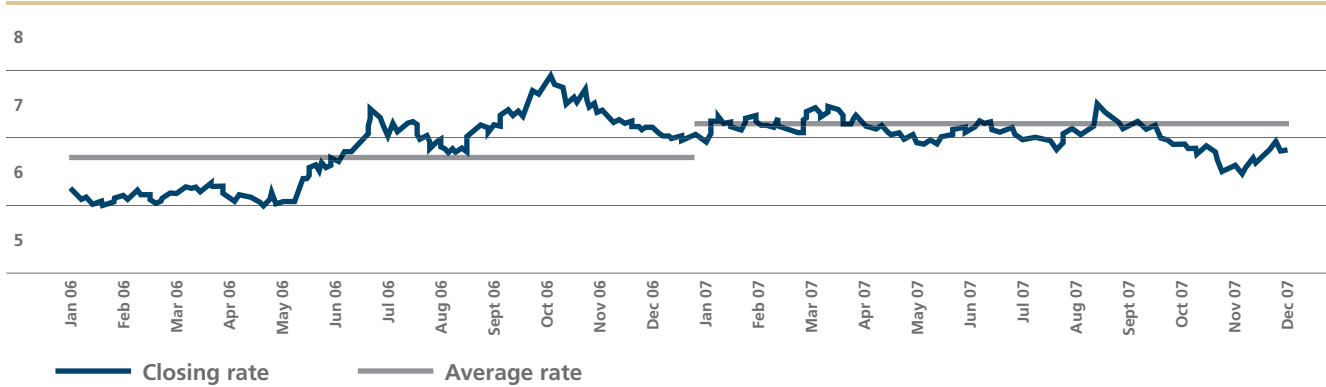
In preparing the condensed consolidated financial report, SIOC Community Development SPV and Envision are considered special purpose entities and are consolidated for accounting purposes. These entities will be consolidated while the funding structures remain (approximately four more years).

These parties along with Kumba participate in the dividend declared by Sishen Iron Ore Company. The following dividends were declared during the year:

Rand million	Total dividend 2007	Final dividend 31 Dec 2007	Interim dividend 30 Jun 2007
Dividend declared by Sishen Iron Ore Company	3,266	1,755	1,511
– Kumba	2,417	1,298	1,119
– Exxaro Resources	653	351	302
– SIOC Community Development SPV	98	53	45
– Envision	98	53	45

During 2007, R11 million was paid to employees of Sishen Iron Ore Company through the dividend received by Envision and R7 million to the SIOC Community Development Trust through its interest in the SIOC Community Development SPV. The remaining dividend received by Envision and the SIOC Community Development SPV is used to reduce the funding put in place to acquire the underlying interest in Sishen Iron Ore Company.

Rand/US Dollar exchange rate



Key factors affecting future operating results

Export iron ore price

Iron ore is a critical input of the global steel industry, with world crude steel production increasing 7.5% in 2007. The seaborne market for iron ore has grown from 454Mtpa in 2000 to 782Mtpa at the end of 2007.

Higher demand for iron ore and continued difficulties by suppliers in bringing on new production to meet this demand, coupled with logistical constraints, have underpinned a significant increase in the benchmark iron ore price in recent years.

Exchange rate

Kumba's revenue generated from the export of iron ore and shipping services, which represents some 88% of revenue generated, and a significant portion of Kumba's capital expenditure is affected by the Rand/US Dollar exchange rate. Therefore, the average exchange rate for the year has a significant effect on revenue and operating profit.

In 2008 the Rand/US Dollar exchange rate has already exceeded R8.00/US\$1.00. This weakness in the Rand will have a positive impact on operating profit assuming the average exchange rate for 2008 exceeds the average rate of R7.03/US\$1.00 in 2007. (See graph at top of page).

Energy

As explained by the CEO (p26), Kumba is managing this crisis actively to minimise the impact.

Changes in accounting estimates

The provision for environmental rehabilitation and decommissioning recognised by Kumba is based on management's best estimate of the cost to be incurred. The actual liability for rehabilitation and decommissioning that may arise on closure of the mines can vary from our estimate. As a result, the liabilities we report can vary if our assessment of expenditures changes.

The estimated closure cost for rehabilitation and decommissioning at Sishen Mine and Thabazimbi Mine has been revised during the year to take into account the results of experiments undertaken over recent years for Sishen Mine, an escalation in the cost of rehabilitation and the timing of cash flows.

Rand million	Environmental rehabilitation	Decommissioning	Total
The effect of these changes is detailed below:	140	8	148
Discount rate	50	11	61
Amount of the closure cost	168	12	180
Expected timing	(78)	(15)	(93)

Changes in accounting policies

Kumba adopted IFRS 7, Financial Instruments: Disclosures (IFRS 7) and the related amendments to IAS 1, Presentation of Financial Statements and IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (IFRIC 11) with effect from 1 January 2007.

IFRS 7 requires that every business disclose information on the significance of financial instruments and the nature and extent of risks arising from these financial instruments. The disclosure requirements of IFRS 7 have been applied retrospectively.

The amendment to IAS 1 requires disclosure of the objectives, policies and processes for managing capital. IFRIC 11 provides guidance on applying IFRS 2, Share-Based Payment in circumstances where an entity chooses or is required to buy its own equity instruments (treasury shares) to settle the share-based payment obligation.

The adoption of this standard, the related amendment and interpretation has had no effect on the financial results and financial position of Kumba.