

Commentary

Highlights

At R6.5 billion Kumba's headline earnings for the six months ended 30 June 2010 were 90% above the R3.4 billion achieved in the first half of 2009. This operational and financial performance was due to the implementation of the group's production and sales growth plans and cost containment initiatives, notwithstanding the legal issues which arose in the first half of 2010 and are referred to in note 11 to the reviewed condensed consolidated interim financial report. Kumba continues to deliver increasing value to its shareholders. Through capital appreciation and substantial dividend cash returns to its Black Economic Empowerment ('BEE') shareholders, Sishen Iron Ore Company (Pty) Limited ('SIOC') has contributed towards its commitments to South Africa and empowerment. Attributable and headline earnings for the period were R20.27 and R20.28 per share respectively, on which an interim cash dividend of R13.50 per share has been declared.

Sishen Mine's production increased by 17% year-on-year or 3.1Mt to 21.1Mt, principally through the Jig plant ramping up to name plate capacity, and remains on track to achieving an overall increase of 5% in production volumes for 2010.

The development of Kolomela Mine in the Northern Cape continues and overall project progress remains on budget and on schedule to deliver initial production during the first half of 2012.

Operating profit increased by 64% from R6.8 billion to R11.2 billion improving the group's operating profit margin from 57% in 2009 to 63%. The operating profit achieved was impacted by the implementation of the South African mining royalty effective from 1 March 2010 as well as the relative strengthening of the Rand against the US Dollar. Operating expenses (excluding the royalty expense of R546 million) increased by 18% to R6.1 billion. Sishen Mine's unit cash cost increase was held below 4%. The increase in production cost due to the 23% increase in waste mining was more than offset by the benefit of increased production. Sishen Mine's unit cash cost for the six months was R102.71 (US\$13.66) per tonne compared to R98.83 (US\$11.78) per tonne at the end of 2009.

The group's strong cash flow generation has enabled the declaration of an interim and final dividend since listing on the JSE Limited in November 2006, returning R14.0 billion to shareholders to date. This return of cash to shareholders has assisted in reducing the acquisition debt of the BEE shareholders of SIOC. Less than four years after its establishment, using the dividends received from SIOC, the SIOC Community Development Trust will be in a position to fully redeem the R458 million preference shares issued to pay for its 3% interest in SIOC in the third quarter of 2010, well ahead of the original projections. This will result in the trust holding an unencumbered 3% interest in SIOC (now valued at R3.8 billion based on Kumba's share price of R316 on 30 June 2010) and the ability to apply all future dividend cash flows to progress its community development objectives. This is a significant milestone for BEE and a very worthy initiative to empower our key communities where we operate. In future Kumba will deconsolidate this 3% shareholding, once the preference shares are fully redeemed.

Safety performance

On 23 February 2010 we regrettably suffered one fatality when Mr Bosiamane Moses Machacha, an employee at Kolomela Mine, was fatally injured during road construction on the Witsand access road to Kolomela Mine. The Board and management once again extend our sincere condolences to the family, friends and colleagues of Mr Machacha.

Kumba remains committed to zero harm at all the group's sites. Kumba's overall safety performance improvements suffered a number of setbacks during the first quarter of 2010, however, this trend has reversed during the second quarter. The group recorded nine lost-time injuries ('LTI's') for the period, which has resulted in the lost-time injury frequency rate ('LTIFR') of the group increasing to 0.11 compared to the 0.07 achieved in 2009. Sishen Mine recorded five LTI's, Thabazimbi Mine three LTI's and there was a single LTI at Kolomela Mine. Since that LTI, Kolomela Mine has achieved 3.8 million LTI-free man-hours to date. Sishen and Thabazimbi mines worked the full six months without a fatality. Sishen Mine has now worked for 26 months without a fatality and Thabazimbi Mine has been fatality free for over seven years.

Market overview

The increased demand for iron ore during 2010 is underpinned by higher world crude steel production, which is estimated to increase to 1.37 billion tonnes in 2010, a 4.6% increase year-on-year. China's crude steel production during the first five months of 2010 increased by 21% year-on-year, whilst iron ore imports into China over the same period increased by 4.1% year-on-year. This increase in iron ore imports was mainly impacted by the re-opening of many domestic iron ore mines in China, driven by the much improved iron ore spot prices, higher freight rates and an increasing demand for iron ore in the traditional markets of Europe, Japan and Korea on the back of improved market conditions, which further reduced the seaborne iron ore available to China.

Having assessed industry developments, Kumba has moved to implement quarterly pricing for its long-term contracts. The majority of export sales volumes are currently committed to long-term contracts and the remainder is sold at index prices mainly to annual customers and as additional volume to long-term customers in China. Quarterly benchmark prices for the April-June quarter have been negotiated on the basis of average index prices in the period December 2009 to February 2010, and have increased on average 100% compared to 2009/10 iron ore year benchmark prices. However, a pricing mechanism for future quarters is still under negotiation with customers and changing market conditions have led to significant uncertainty in iron ore prices in the short-term.

Operational performance

Total tonnes mined at Sishen Mine increased by 21% from 59.8Mt in 2009 to 72.1Mt, of which waste mined was 46.1Mt, an increase of 23% from the first six months of 2009. This increase in waste mining activity is undertaken to mitigate decreasing geological quality in the pit and to cater for increased production. Total production at Sishen Mine increased by 17% from

18.0Mt in 2009 to 21.1Mt. Production from the Dense Media Separation ('DMS') plant increased by 1.1Mt to 14.7Mt due to an improved plant yield. The ramp up of production from the Jig plant continues as planned and increased by 7% from the 6.0Mt achieved in the second half of 2009 to 6.4Mt, and now contributes 30% of Sishen Mine's production. The Jig plant remains on schedule to produce between 12.5Mt – 13.0Mt during 2010.

The group increased total sales volumes by 10% from 20.0Mt in 2009 to 21.9Mt. Export sales volumes from Sishen Mine for the six months increased by 1.7Mt or 10% from 17.1Mt in 2009 to 18.8Mt on the back of increasing demand from our traditional markets. Export sales volumes into Europe, Japan and Korea recovered to 7.9Mt compared to the 2.8Mt in the first half of 2009. Export sales volumes into China of 10.8Mt totalled 57% of total export volumes for the six months, 24% down from the 14.3Mt in the first half of 2009 as sales returned to traditional markets in Europe, Japan and Korea. Aggregate domestic sales volumes for the first half of 2010 were 3.1Mt, up 0.2Mt from 2009 first half sales. During the first half of 2010, Kumba sold 5.2Mt (or 28% of export volumes) at index prices taking advantage of higher prices during this period.

Volumes railed on the Sishen-Saldanha export channel increased by 8% to 18.2Mt (including 0.6Mt railed to Saldanha Steel). This performance was impacted by the industrial action at Transnet and a significant derailment in April 2010 which together accounted for approximately 1.2Mt of "lost" export sales volumes. Kumba implemented contingency plans to aid the railing and loading of iron ore for export throughout the period of industrial action at Transnet. These plans were successful in partially mitigating the impact of the strike action upon Kumba's operations. The stock on hand at the Saldanha port and 17.6Mt railed during the period enabled Kumba to load 19.1Mt at the port destined for the export market.

Waste mining at Thabazimbi Mine increased by 152% to 14.1Mt as new pits are opened as part of the extension of the life of mine to 2016. Production at Thabazimbi Mine reduced by 27% to 0.8Mt for the six months, in line with the progression towards the end of the life of the mine. Domestic sales from the mine were flat due to the off-take requirements of ArcelorMittal South Africa Limited ('ArcelorMittal') and logistics constraints.

Financial results

The group's total mining revenue (excluding shipping operations – R1.6 billion) of R16.2 billion for the period was 55% higher than the R10.4 billion of the same period of 2009. This performance was achieved on the back of an average increase of 100% in contract iron ore export prices for the second quarter of 2010, a 10% increase in total sales volumes, and the sale of 5.2Mt into China at index prices that traded on average above contract prices and peaked above US\$200 per tonne in April 2010.

Operating profit of R11.2 billion was achieved for the six months, an increase of R4.4 billion or 64% from the R6.8 billion during the first half of 2009. Kumba's operating profit margin of 63% for the six months (68% from mining activities), increased by 6% from 57% (62% from mining activities) in 2009.

Operating profit increased by 64% or R4.4 billion, principally as a result of:

- A weighted average increase of 73% in iron ore export prices, which added R8.1 billion to operating profit and a 10% growth in export sales volumes contributed R1.0 billion.

This increase was offset by:

- The strengthening of the average exchange rate of the Rand to the US Dollar (average exchange rates – R7.52/US\$1.00 for the first six months of 2010 compared with R9.16/US\$1.00 for the same period of 2009), which reduced operating profit by R3.1 billion;
- A R1.0 billion or 23% increase in operating expenses (excluding shipping expenses) as a result of the 23% and 152% increase in waste mined at Sishen and Thabazimbi mines respectively, a 17% increase in volumes produced, and an 8% increase in volumes railed which was compounded by an increase in logistics costs. This increase was further fuelled by inflationary pressures and significant increases in the cost of diesel and electricity;
- The commencement of the mining royalty payable for the four months from March to June 2010 at an effective rate of 4.8% of free-on-rail ('FOR') iron ore revenue, which added R546 million to operating expenditure; and
- A R64 million decrease in profit from shipping operations. Total tonnes shipped by Kumba decreased by 2.9Mt from 12.1Mt to 9.2Mt for the first six months of 2010.

Notwithstanding the increase in activities, including a 23% increase in waste mining, Kumba reduced Sishen Mine's unit cash cost from R104.12 during the first half of 2009 to R102.71 for the same period of 2010. This reduction was aided by a 17% increase in production over the first half of 2009. The unit cash cost for the period has been kept flat in real terms when compared to the R98.83 achieved for the full 2009 year. Waste mining is expected to increase by a further 25% in the second half of 2010 which will add upward pressure to unit costs. However, to mitigate this, Kumba remains focused on achieving further benefit from successful cost management, operational efficiency and revenue enhancements initiatives from its asset optimisation programmes and participation in the Anglo Supply Chain procurement organisation. Cost control continues to be a major focus of the group as it faces the challenges of increased waste mining at its operations. The flagship Sishen Mine transformation programme ('Bokamoso') has delivered further mining operational efficiency gains and contributed to the increased production of the mine through improvements in the DMS and Jig plant yields during the period and reaping the ongoing benefits of prior years through the reduction in the maintenance shutdown period of the DMS plant. Further value has been extracted by Kumba through its marketing initiatives to enhance the premia achieved on its niche lump products, capturing the differential between index export prices and benchmark contract prices by selling 5.2Mt of uncommitted Sishen Mine production at index prices, professionalising its shipping operations and deriving incremental value through benchmark contract price negotiations relative to market movements. These asset optimisation and procurement initiatives have delivered R917 million in increased revenues and price benefits, operating cost containment of R292 million and reduction in capital expenditure of R45 million during the period.

The group continued to generate substantial cash from its operations, with R9.5 billion generated during the six months. These cash flows were used to pay taxation of R2.6 billion and aggregate dividends of R3.0 billion during the six months. Capital expenditure of R1.5 billion was incurred, of which R233 million was to maintain operations and R1.2 billion to expand operations, mainly on Kolomela Mine. At 30 June 2010 the group had a net debt position of R918 million (R3.0 billion at the end of 2009). Interest cover remained strong at 53 times (43 times at the end of 2009).

Kolomela Mine

For the first six months of 2010, 8.2Mt (4.0Mt in the second half of 2009) of waste material has been mined at Kolomela Mine in the process of developing the first pit at a capitalised cost of R226 million (R181 million in 2009). The project has seen significant progress during the period with key deliverables and major construction elements well advanced. Whilst the construction activities are gaining momentum, the safety focus on site remains the top priority with an ongoing intensive programme to entrench the zero harm objective.

R4.4 billion of capital expenditure (including R407 million of capitalised mining operating expenses) has been incurred to date, of which R1.1 billion has been incurred during the six months ended 30 June 2010. This includes R226 million mining operating expenses incurred during the six months.

Mineral resources and ore reserves

There have been no material changes to the ore reserves as disclosed in the 2009 Kumba Annual Report. Kumba is engaged in the improvement of the information and models, which form the basis of the annual mineral resource and reserve estimation.

Prospects

Due to the large gap between current index prices which are lower than the implied July-September 2010 quarterly benchmark prices, uncertainty exists around future export iron ore pricing mechanisms and price levels for iron ore. In an operating environment where steel production rates are being reduced it is uncertain whether increased iron ore prices under the quarterly pricing mechanism can be passed to customers. Chinese steel production and iron ore imports in the second half of 2010 are expected to be marginally below levels achieved during the first half as Chinese steel mills prioritise cost over productivity and therefore focus on the use of domestic iron ore. The momentum of the recovery of Kumba's traditional markets is slowing. Export sales volumes into China are expected to normalise at around 60% of the geographical sales mix.

Domestic sales volumes from Thabazimbi Mine remain dependent on the off-take requirements from ArcelorMittal. Domestic sales volumes from Sishen Mine to ArcelorMittal remain under dispute and the further supply of iron ore is dependent on arriving at an acceptable interim pricing agreement.

Waste mining at all the operational sites is anticipated to increase, which will put upward pressure on unit cash costs of production. Kumba remains committed to a 5% increase in annual production volumes during 2010, with the continued ramp up of the Jig plant.

Relative to the US Dollar, the South African Rand has strengthened a further 4% from the end of 2009. Kumba's operating profit remains highly sensitive to the Rand/US Dollar exchange rate. The introduction of the mining royalty during the first half of 2010, which was in place for four months, will increase as it is accounted for the full six months of the second half of 2010.

Management focus will be on optimising the asset base, operational and cost efficiencies and the group's production and sales volume growth plans to lessen the adverse effects of the stronger Rand, mining royalty and the cost pressures driven by the increase in waste mining.

Change in directorate

The Board of directors of Kumba announced the appointment of Mr Godfrey Gomwe as a non-executive director with effect from 17 May 2010. Mr Gomwe is an executive director of Anglo American South Africa Limited and he serves on a number of Anglo American South Africa Limited operational boards and Thebe Investment Corporation (Pty) Limited as a non-executive director.