AngloAmerican KUMBA IRON ORE

Conference call transcript

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INTERIM RESULTS PRESENTATION

Norman Mbazima

Thank you, Yvonne. Good morning and welcome, ladies and gentlemen. Thank you for taking the time to be here this morning. A very special word of welcome to members of the Kumba board, to our Chairman, Fani Titi, and also to Allen Morgan, Zarina Bassa and Litha Nyhonyha. Welcome also to Sipho Nkosi and his colleagues from Exxaro. Vusani Mali is here as well from SIOC Community Development Trust. And as always, to Kumba's Old Boys Club, today represented by Con Fauconnier.

Now, I noticed that it is written pensions unlimited today. We are looking at Kumba's interim results for the six months ended 30th June 2014. As you all know the market was tough in the first half of the year with iron ore prices falling significantly. We are however very pleased with our steady performance overall for the period.

The most important aspect of our work is the safety and health of everyone in our organisation and ensuring we go home unharmed every day. Regrettably we had one fatality at Sishen in April. As we know, we spent a lot of time and effort last year reviewing our strategy and the technical and operational performance of our assets. We developed detailed plans and have been focussed on implementing these in this first half of 2014.

We delivered a solid operational performance for the half year with production up 5% as Sishen's performance improved and the strong performance at Kolomela mine continued. Despite the 17% decreased in export iron ore prices realised for the period which negatively impacted the headline earnings per share, the board approved an interim dividend of R15.61 per share, a dividend cover of 1.3 times.

As I mentioned earlier, we had a fatal accident at Sishen mine. One of our colleagues tragically lost his life when he fell from height while doing maintenance work on a crane in the DMS plant. We continue to keep his family and friends in our thoughts and prayers as their lives have been permanently changed by this irreplaceable loss. We believe that every incident is preventable, and any loss of life points to failures that need correction. We have completed investigations into the tragic incident and are putting into place measures to avoid a recurrence of this incident.

We have responded to the deterioration in our safety performance by investing greater effort in ensuring that critical controls and engineering solutions are developed for our priority risks. Work completed includes anti-rollback and also retardation [?] mechanisms on our haul trucks. We continue to review our programmes and are placing greater emphasis on accountability and operational discipline to encourage employees not to take shortcuts but to follow the correct safety procedures in all tasks. We are also encouraged by the proactive and preventative engagement that the DMR has had with us. As a company we remain committed to exceeding regulatory compliance and fulfilling our aspirations of zero harm.

On the labour front Kumba remains the largest private sector employer in the Northern Cape and we have over 13,000 employees. We are pleased to report that we had a stable labour environment across all our operations in the first half. Wage negotiations commenced in June 2014 and we are optimistic that we will come to a settlement soon.

Turning now to the market performance for the period. Crude steel production increased globally by 3.5% with China, Europe, Japan and Korea all showing improvement. China at 5% showed slower growth than in the first half of 2013 as concerns remain over the underlying trends of demand in China on the back of slowing economic growth. Crude steel production growth in Europe was boosted by a positive PMI figures in most of its major markets. And growth in Japan and Korea was mostly supported by strong domestic demand. As you can see on the graph crude steel production from the rest of the world remained stable.

The market was dominated by Australian expansions adding to supply and growing exports by 25%. Brazil and South Africa increased exports by 8% and 3% respectively. Chinese imports grew by 19% displacing some high-cost domestic material to absorb the increased supply. Prices came under pressure in the first half and averaged $111, down by 19%.

Credit conditions in China were tied to banks unwilling to extend funding to steel mills and steel trading houses despite clear signs of margin improvement at the mills. But the pressure on iron ore prices was mostly due to increased supply. As we have seen on the previous slide, seaborne supply increased by 15% but global crude steel production increased by only 3.5%, so steel mills were effectively spoilt for choice and prices declined as a result.

The iron ore index steadily declined throughout the first half of 2014 with the 62% Fe Platts index dipping just below $90 in June before finding some support and recovering slightly. In the second half a modest growth in seaborne iron ore supplies is expected from Australia and Brazil. Prices are expected to remain at current levels in the third quarter with a slight recovery towards the end of the year as domestic Chinese iron ore production slows and steel mills rebuild stocks ahead of their winter.

Turning now to the operational review for the period. Firstly Sishen mine. To recap, the comprehensive technical studies that we concluded last year confirmed that Sishen would produce on average 37 million tonnes per annum for the remainder of its life. We indicated that production even at this level would be challenging in the short-term while significant ramp-up of waste removal to around 270 million tonnes in 2016 was being undertaken.

The redesign of the pit continues with the redesign of the western pushbacks, the main production areas of the Sishen pit, being completed in the first half. This resulted in an improved mining plan enabling better utilisation of equipment. Our level of exposed ore has improved, giving us greater confidence of meeting the 2014 production target. As part of this redesign around 600 million tonnes of waste has been removed from Sishen's life of mine. We do not need to mine it. This has reduced the life of mine stripping ratio to 4 from the previous 4.4. We will continue to optimise our life of mine plan, which may cause this figure to vary.

While we are pleased with the first half progress at Sishen there is still work to be done to get the mine to where it needs to be to achieve 37 million tonnes by 2016. A core focus area is to improve productivity at the mine. Sishen is implementing the first business process framework in the Anglo American group. Implementation will commence in August and will focus on productivity improvements through improved work management at the internal work mining operations at Sishen. Later this will be extended to the pre-stripping operations. The set-up which commenced late last year has now been completed. We expect BPF not only to improve productivity but to enable us to maintain a steady production rate.

As you are aware, we plan to relocate the Dingleton community to Kathu. This is a very important element of the Sishen expansion to ramp up production to get 37 million tonnes by 2016. The project is in progress and construction of houses has commenced. In addition, schools, churches and businesses will also be built. We continue to engage extensively with the affected community. We are dealing with people and their home, and we approach any challenges with sensitivity and empathy. We will be constructing two new waste dumps which will result in shorter hauling distances and better utilisation of equipment.

This year completed our initial five year acquisition plan. We are currently finalising the pit plan for the next five years, a period when we will be reaching our peak waste mining. This is a full plate of work for Sishen, full of challenges, but we are confident in our ability to deliver. We are on course to meet our 35 million ton production target for the year, 36 million tonnes in 2015 and 37 million tonnes in 2016. Although these are tough targets the technical work that we have conducted and our execution in the past six month indicates that these are achievable.

I'm pleased that Sishen's production increased by 6% to 17 million tonnes, in line with the mining plan. Excessive rainfall in the first quarter and unseasonable rain during May made for difficult mining conditions, especially in the pre-stripping operations. This added to challenges with new equipment and newly licensed operators. The pre-strip waste is about 10 million tonnes behind our plan as a result. Total waste removal, however, increased by 6% as we exceeded our targets on internal waste. This bodes well for us reaching the 35 million ton production for this year.

Waste mining plans for the second half of the year have been completed and are in execution. This includes further fleet efficiency improvements and require increased run rates. July is a big month for us, and we have already seen significant fleet performance improvement both by the contractor and in our own fleet. We therefore expect to move around 220 million tonnes of waste at Sishen this year.

Now on to Kolomela. You remember that 2013 was exceptional for Kolomela, producing almost 2 million tonnes above the original target of 9 million tonnes. Kolomela continued with its strong performance in the first half, achieving excellent production of 5.5 million tonnes, up 4% on the quarter to June 2013, and also increasing waste mined by 12% to 24.4 million tonnes.

During the first quarter a reclaimer at Kolomela which moved product onto the rail loading conveyer experienced a structural breakdown and was out of service for five weeks. This event reduced dispatches from Kolomela and resulted in an increase of finished product stocks at the mine. The reclaimer has been repaired and we expect some catch-up in the second half. We confirmed in February that Kolomela is planned to produce 10 million tonnes per annum for the remainder of its life. We expect to achieve this in 2014 and we will obviously try to do better than that. Pre-stripping of the third pit, Klipbankfontein, has progressed very well and is aimed at maintaining mining flexibility through the life of this mine.

Following the agreement with ArcelorMittal SA which came into effect in January this year a major reconfiguration is planned for Thabazimbi, as mentioned previously. Our intent remains to harness all the remaining sources of ore, especially the low-grade ore previously included in the Phoenix project, to make a lower cost, longer life mine producing about 2 million tonnes per annum. This is in feasibility stage and will take some time to progress. Due to the introduction of new technology and the variety of different ores to be mined this project carries some risks.

Thabazimbi is an old mine, and we continue to mine out the last of the resource. As we do this there will be some geological risks. Thabazimbi produced 0.3 million tonnes for the period. Waste mining was up 18% with mostly pre-stripping in the Kumba pit taking place in the first half in readiness for increased ex-pit ore production in the second half. Thabazimbi is on track to increase production to around 1 million tonnes this year.

Ore railed to Saldanha was 5% down due to the reclaimer breakdown at Kolomela in the first quarter, resulting in increased product stock at the mine. Except for the reclaimer breakdown logistics operations during the period went very well, resulting in 19.3 million tonnes shipped and export sales of 19.7 million tonnes.

CFR sales accounted for 62% of our overall export sales, slightly lower than last year's 63%. This year we secured a number of short-term contracts at a discount to the Platts freight rate for the Saldanha-Qingdao route. Domestic sales to ArcelorMittal SA continued to increase in line with their demand and well within their contracted tonnages.

The 62% Fe Platts index fell by $25.40 and the Platts freight rate on the Saldanha-Qingdao route increased by $2.40, implying a FOB price decline of around $28. However, our average FOB realised price was higher, falling by only $21 as we benefited from some of our lagging pricing contracts. Contract sales accounted for 72%, down 5%, mainly due to the movement of current customers from contract to spot.

Sales to India also increased in the second quarter when price volatility made it difficult for some Chinese customers to buy on contract. The geographic mix of export sales remains similar to 2013 with China continuing to account for about two-thirds. Most of our sales to China are now priced on index values around the discharge date. Outside of China a lagging quarterly pricing mechanism continues to be applied in Japan only, and current quarter pricing used in Europe and Korea.

Lump premiums declined significantly since the beginning of the year as more lump came onto the market through the Australian capacity expansion. And some steel mills reduced lump usage after completing investments in their sinter plants to become compliant with environmental regulation. The spot lump premium sales at the lowest level of the year was at around 4 cents in early June as buyers were unwilling to pay the higher prices. On average we achieved lump premiums very much in line with the average spot lump premium as published by Platts, starting very strongly in the first quarter but declining sharply towards the mid-year.

We move now to our growth plans. We remain focussed on delivering our growth strategy targeting around 5 million tonnes in South Africa over the next three to five years through incremental growth at Sishen and Kolomela. All projects which are listed on the slide are in different stages of study and subject to our normal governance approvals.

During the first half progress was made on the following projects. The Jig -1mm feasibility study made good progress and an investment decision is expected in the second half. We are progressing the Kolomela expansion project through a phased approach over the next few years. Firstly we wish to increase Kolomela's production to around 11 million tonnes per annum through de-bottlenecking and optimisation of the plant and have commenced a study to achieve this. Thereafter we wish to increase production by a further 2 million tonnes per annum through maximising potential of the DSO resource out of the existing three operational pits. Phase three of the expansion is still at an early stage of study and would aim to produce ore from additional pits whose resources are currently in exploration.

During the half year we completed testing of ultra-high dense medium separation, UHDMS, technology and the results have been positive. We intend to deploy this technology at Sishen to feed jig discard material and at Thabazimbi to process lower-grade ore to produce an additional 1 million tonnes per annum.

The Thabazimbi reconfiguration project is in feasibility study, but if this proves viable it will enable Thabazimbi to become a long life, lower cost mine. We expect the feasibility study to continue well into 2015.

Again it is important to note that these projects are dependant on the expansion of the iron ore export channel, and we are working with Transnet to establish solutions for short-term, incremental expansion of the line to accommodate the growth.

Despite the drop in market prices Kumba's long-term growth strategy has not changed. As you are aware, we constructed the UHDMS pilot plant at Sishen. Studies are in progress to determine value-accretive options to deploy UHDMS and other low-grade technologies to turn to account the C grade material at Sishen.

In West Africa we completed and closed the exploration in Liberia with Jonah Capital as the result proved uneconomic. We identified a number of opportunities in Central and West Africa and are currently investigating their potential. I will now hand you over to Frikkie to talk about the financials.

Frikkie Kotzee

Thank you, Norman. Good morning everybody. Over the past six months Kumba's financial results reflected the solid operational performance described by Norman on the one hand, and on the other hand it was impacted by lower iron ore prices as well as volatile market conditions. To date in 2014 the group achieved revenue of R26.4 billion.

Operating profit of R12.3 billion was 14% down from a profit earned in the first half of 2013. Headline earnings per share of R20.28 decreased by 16% on a year on year basis. After considering a number of factors, iron ore price volatility and the group's capital expenditure requirements an interim cash dividend of R5 million or R15.51 per share has been declared at a 1.3 times cover. The capital expenditure was R3.3 billion. We ended the six months in a net debt position of R687 million.

Turning to our financial review. Revenue remained strong at R26.4 billion, mainly due to a favourable impact of the deprecation of the Rand offset by a decline in realised iron ore export prices. As you can see on the slide, operating expenses increased to R14.1 billion. This was driven principally by the growth in mining volumes as well as higher logistics costs. Although our operating margin decreased by 8% it is still good at 47%, while the group's mining margin remains robust at 55%.

Profit for the group amounted to R8.6 billion, of which R6.5 billion is attributable to the shareholders of Kumba and R2.1 billion is SIOC empowerment shareholders. Headline earnings of R6.5 billion or R20.28 per share decreased by 16% year on year. Our effective tax rate increased to around 29%, which is 1% more than in 2013, mainly due to a once-off recoupment relating to the new domestic supply agreement with Amsa.

Cash generated remained healthy at R15.3 billion, R1.8 billion down from 2013 on the back of lower iron ore prices. Capex of R3.3 billion was incurred, and we expect to spend around R8 billion in 2014.

Analysing the R130 million increase in revenue. R26.4 billion is made up of R24.3 billion from mining and R2.1 billion from shipping operations. The increase was driven by a 16% weaker Rand against the US Dollar, raising revenue by R3 billion. R556 million was shipping income earned on 12.2 million tonnes in total on contract and spot charters. 0.4 million tonnes higher total sales volumes impacted revenue by R33 million. This was largely offset by a 17% decline in realised iron ore export prices, reducing revenue by R3.5 billion on a year on year basis.

Kumba sold a total of 2.8 million tonnes to Amsa under the new supply agreement at an average price of around R663 per ton from Sishen and at R827 per ton from Thabazimbi. Further details are provided in annexures one and two.

Now to operating expenditure. The ramp-up in the waste mining volumes at Sishen and Kolomela mines continued during the period under review, and this resulted in increased costs. Kumba's operating expenses are R13.3 billion excluding royalties, grown by R2 billion, and can be analysed as follows. In line with the mining industry we had cost escalations of around 8% in our key commodities, including diesel and rising mining contractor rates, an improvement on previous periods. This together with non-cash cost increases and forex movements added R1 billion to our cost base.

The increase in the cost of production of R806 million at our mines is driven by an 8% increase in the waste volumes that the group pre-mined, R679 million up on a year on year basis, and once-off sales to Amsa at the effective date of the new supply agreement, impacting stock movements which was R326 million higher. These were offset by R199 million increase in waste stripping costs deferred to the balance sheet. The freight cost of R2.2 billion was incurred on 12.2 million tonnes sold on a CFR basis. This added another R541 million to costs. A decrease of 5% in volume and 4% in shipped tonnes led to R116 million lower selling and distribution cost. The group's driving value initiative is targeting some cost containment. More details on the costs are provided in the annexure.

Now to Sishen unit cash costs. The cash costs of Sishen were essentially stable at R266 per ton compared to R267 per ton in 2013. Waste stripping increased further during the first six months of 2014 to 87 million tonnes, up 6%. A recovery in production volumes as referred to by Norman impacted unit costs positively. At around $25 per ton we remain well positioned on the cost curve. On the graph we see the following key movements in our unit cash cost. One, normal inflationary pressures pushed up costs by around R10 per ton. Above-inflation increases were contained to R2 per ton. A 9% rise in diesel and 8% increase in drilling costs were partially offset by below-inflation increases in contractor rates, cost of blasting materials and tyre prices.

Two, as expected the increase in the mining activity added R15 per ton. These were offset by a production recovery of R26 per ton. In 2014 terms increased waste stripping is expected to add around R26 per incremental waste ton until around 2016. It is important to note that this excludes deferred stripping.

On to Kolomela unit cash costs. Kolomela's unit cash costs for the first half were R211 per ton, R29 per ton higher than 2013. In the cost escalation added R8 per ton, only 1% higher than inflation, and driven principally by higher diesel prices and contractor rates. Further waste mining volume growth increased the unit cost by R7 per ton. This was offset by the impact of increased production volumes of around R2 per ton. Other cash costs in the period included additional drilling costs to ensure optimal placement of our [unclear] and reclaimer related maintenance, adding around R7 per ton, as well as R9 per ton spent on exploration drilling to increase the geological confidence in the resource in the life of mine plan.

Thabazimbi's unit cash costs for the six months were R985 per ton, R340 per ton up on 2013. A cost escalation added R24 per ton, principally due to inflation cost pressures on input costs of higher diesel prices and drilling increased costs by about 1% above inflation. Further waste mining volume growth increased unit costs by R378 per ton. This was offset by the impact of increased production volumes of R77 per ton. Thabazimbi's unit cash costs are expected to decline as the mine continues to ramp up to around 1 million tonnes this year and to stabilise after the completion of a reconsideration and a further two years of higher waste stripping.

Now moving to capex. Kumba spent R3.3 billion on capex during the first half of 2014. Expansion capex amounted to R438 million, largely on the Dingleton project and our SAP system upgrade.

Stay in business capital of R1.8 billion was driven by further ramp-up capital for mining equipment and related infrastructure and on housing development. The capital expenditure includes R643 million for deferred stripping costs at all three mines. Our capex guidance for the year is maintained.

The capex for 2015 and 2016 will include SIB spend on the Sishen fleet together with associated infrastructure to execute the panned Sishen waste ramp-up. We are currently finalising our five-year heavy mining equipment plan. This will also include the capital spend on the Dingleton project which is expected to cost around R4.2 billion over the next four to six years. The unapproved project pipeline in support of our growth strategy is excluded from the forecast. A level of sustainable SIB capital going forward is forecast on average at around R1.7 billion per annum through the cycle. This excludes the ramp-up in the mining fleet at Sishen and related infrastructure mentioned previously. Deferred stripping costs capitalised will increase in line with Sishen and Kolomela's mine plans.

Now to cash flow. We started the year with net debt of R1.8 billion. As can be seen in the graph we generated strong cash flows of R16.3 billion. We returned R8.5 billion in total to our shareholders, R6.4 billion to Kumba shareholders and R2.1 billion to SIOC BEE shareholders. We used R2.4 billion to pay company tax and pay the mineral royalty of R0.9 billion, a total of R3.3 billion to the South African government. Capex was discussed on the previous slide.

Kumba ended the half year with net debt of R687 million. We have significant undrawn committed facilities of R8.9 billion and R7.3 billion in uncommitted facilities. We have drawn down R2 billion of our committed facilities at half year. Together with the uncommitted facility we have just over R16 billion of debt facilities available. On a pro forma basis after payment of the interim SIOC and Kumba dividend we will have peak net debt of around R7.5 billion before cash generation between the end of June 2014 and the dividend payment date.

On to the various dividends. SIOC in its interim dividend for 2014 will return a further R1.8 billion to its empowerment shareholders, bringing the total return since listing to over R23.5 billion. Exxaro will receive R1.4 billion for its 20% interest in SIOC. The SIOC Community Development Trust, which holds an unencumbered 3% interest in SIOC valued at over R4 billion will receive a further R204 million to further its community development projects. Employees continue to share the benefit of SIOC's performance through dividends. With this dividend Envision will receive R210 million.

Now to the interim dividend for Kumba. In line with the board's policy of reviewing the dividend at each declaration date the board increased the cover from 1.2 to 1.3 for the 2014 interim dividend after considering, amongst other factors, iron ore price volatility and the group's capital expenditure requirements. The Kumba board is pleased to announce an interim cash dividend of R5 billion or R15.61 per share. Kumba's dividend policy returning surplus cash to shareholders remains unchanged after consideration of growth and investment opportunities, while remaining within the group's committed debt facilities. Thank you. I now hand you back to Norman.

Norman Mbazima

Thank you, Frikkie. I sometimes forget that I'm a [unclear] accountant. Moving now to our regulatory update. We reapplied for the 21.4% mineral right for Sishen in the first quarter and anticipate this being granted in the near future. We continue to engage with the DMR in this regard. The Mining Charter is being reviewed this year and we are confident that we will meet all the requirements. For us it is not about ticking the boxes but about a successful broad-based transformation of the industry. We have consistently been working towards achieving and in many areas exceeding the objectives of the Mining Charter.

To highlight a few areas, Kumba is fully empowered in terms of the Mining Charter requirement of 26% BEE ownership, and has been so since listing in 2006 when 20% of SIOC was transferred to Exxaro, 3% to the Envision Trust and 3% to the SIOC Community Development Trust. Envision as you know is a very successful share ownership scheme for permanent employees below management level that paid out R2.7 billion to around 6,200 members at the end of its maturity in 2011. In addition, employees received a total of R775 million in dividends over the last seven years. The SIOC CDT distributes benefits to more than 300,000 people in the communities around our mines through beneficiary trusts.

Moving on to our outlook for the remainder of 2014. Sishen is on track to produce 35 million tonnes and mine around 220 million tonnes of waste, recognising the importance of mining the correct amount of waste at the right places in the pit. We expect Kolomela to produce around 10 million tonnes and will do more if we can. Waste mining at Kolomela is expected to be between 40 million and 50 million tonnes. Thabazimbi should increase production to around 1 million tonnes this year.

Export sales volumes are likely to be in line with 2013 levels and our contract with ArcelorMittal SA is for 6.25 million tonnes per annum. Prices are expected to remain at current levels in the third quarter. A slight recovery is expected towards the end of the year as domestic Chinese iron ore production slows and steel mills rebuild stocks ahead of their winter.

Lump premiums are expected to increase to approach the marginal cost of sintering in the second half of the year. Our profitability is sensitive to the iron ore price and to the exchange rate. We remain very conscious of the fact that the biggest investment case for Kumba is its high dividend yield. As Frikkie mentioned, we will continue to pay healthy dividends to our shareholders.

So in summary, we continue our focus on safety and achieving zero harm. We are on track to restore Sishen's production to 37 million tonnes by 2016. While our financial performance was impacted by lower iron ore prices in the first half we have continued to deliver outstanding returns to our shareholders through dividends. Thank you for your attention, ladies and gentlemen.