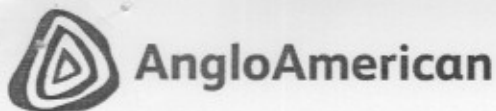


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Ms. J. Fubbs  
Chairman, Parliamentary Portfolio Committee  
Box 11  
Parliament  
Cape Town  
8000

23 August 2010

Dear Ms Fubbs

**Questions raised by the Parliamentary Portfolio Committee ("the Committee") subsequent to the engagement between the Parliamentary Portfolio Committee and Kumba on 13 August 2010**

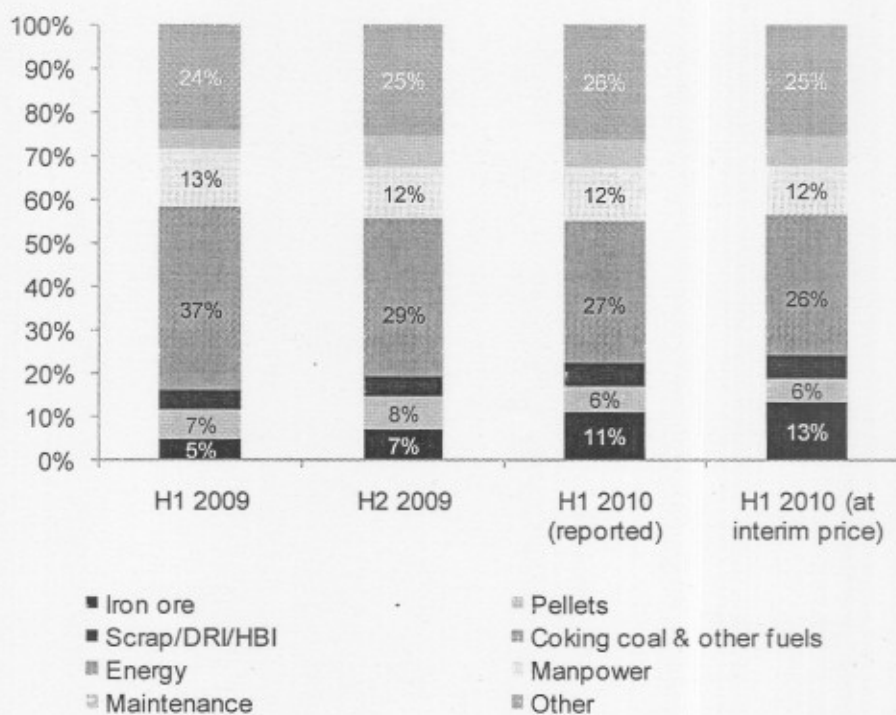
1. I would like to thank the Committee for the opportunity of presenting on Friday, 13 August 2010. Kumba believes that it is important for a rigorous debate to take place in respect of the issues which have been raised following ArcelorMittal South Africa Limited's ("AMSA") failure to convert its old order mining rights in respect of 21.4% undivided rights in respect of the Sishen Mine.
2. As you may be aware, Kumba has been invited to participate in discussions, along with ArcelorMittal South Africa Limited's ("AMSA"), with an inter-departmental Government Task Team ("the Task Team"). The terms of reference for those discussions have not yet been set, but Kumba looks forward to engaging extensively with the Task Team in due course.
3. Certain of the questions raised by the Committee in its letter of 13 August 2010 are complex issues that Kumba believes merit a more detailed analysis and response, than is possible in the time afforded to Kumba to respond to your letter. I hope that the answers set out in Appendices A and B will be of assistance to the Committee.
4. Kumba believes, that as a significant player in the iron ore industry, it can continue to facilitate Government's developmental objectives and create substantial value through:
  - a. Meaningful broad based equity participation;
  - b. Social development of the communities located in the areas surrounding its operations;
  - c. An ongoing commitment to building capacity for future growth through strengthening the skills and human resources base;

**A member of Anglo American plc group**

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Incorporated in South Africa. Registration Number: 2005/015852/06

**Directors:** PL Zim - Non-Executive Chairman, Cl Griffith - Executive Director (CEO), VP Uren - Executive Director (CFO); **Non-Executive Directors:** ZBM Bassa, GG Gormwe (Zimbabwean), GS Gouws, PB Matlara, DD Mokgalle, AJ Morgan, DM Weston (British), VF Malie - Company Secretary

- d. A commitment to a successful combination of preferential procurement and enterprise development, leading to the creation of sustainable empowered businesses; and
  - e. Ongoing substantial investment in new iron ore projects and beneficiation.
5. The additional questions raised clearly indicate that a principal concern of the Committee is the effect of iron ore prices on the national developmental objectives of supporting downstream beneficiation and creating a strong manufacturing sector. Kumba is cognisant of the objectives regarding downstream beneficiation and is involved in a number of beneficiation initiatives. It should be noted, however, that the domestic steel price is not influenced by the price at which iron ore is supplied from the Northern Cape iron ore mines and therefore the price at which Kumba sells iron ore to AMSA should have no effect on these developmental objectives.
6. As a result of a lack of competition in the domestic steel industry, AMSA has been able to set domestic steel prices based on the price at which steel imports could be delivered into South Africa ("import parity prices" or 'IPP'). This meant that, ever since the unbundling of Iscor in November 2001, there has been no link between the price at which AMSA acquired iron ore from Sishen and the price at which AMSA sold steel to domestic consumers. Because domestic steel prices remain linked to steel IPP, domestic steel prices, including those charged by AMSA, are already as high as they can be and an increase in AMSA's iron ore costs can have no material effect on domestic steel prices.
7. Kumba believes that the price at which it sells iron ore to AMSA should have no effect on these developmental objectives. There has, since the unbundling of Iscor in November 2001, been no link between the price at which AMSA acquired iron ore from Sishen and the price at which AMSA sold steel to domestic consumers.
8. Any increase (or decrease) in the price that AMSA pays for Sishen iron ore will have no effect on domestic steel prices.
9. As a result of a lack of competition in the domestic steel industry, AMSA has been able to set domestic steel prices based on the price at which steel imports could be delivered into South Africa ("*import parity prices*" or "*IPP*"). Accordingly, domestic steel prices, including those charged by AMSA, are already as high as they can be and an increase in AMSA's iron ore costs should have no material effect on domestic steel prices.
10. These observations imply that, even if Kumba were to reduce the price of iron ore, it would have no effect on domestic steel prices and hence no effect on downstream beneficiation.
11. The Committee may find the following graph of interest as it depicts the various input costs of AMSA (as derived from its published financial statements) and shows that the most significant input costs relate to energy, coking coal and other fuels, with total iron ore costs (including pellets) comprising 1.1% of total costs, as per reported H1 2010 results.



12. Other steel producers in South Africa purchase their inputs from third parties at market related prices (most of these steel producers rely on scrap steel as an input and not on iron ore from the Sishen mine). These domestic steel producers include Highveld Steel & Vanadium Corporation Limited ("**Highveld**")<sup>1</sup>, Scaw South Africa (Proprietary) Limited ("**Scaw**"), Cape Gate (Proprietary) Limited ("**Cape Gate**") and Cape Town Iron and Steel Works (Proprietary) Limited ("**CISCO**"). Kumba understands that an entity called SA Steelmakers has recently commenced producing steel products in Cape Town.
13. The historical preference which has been accorded to AMSA through preferential iron ore pricing has not benefited downstream users of steel, nor has this preference resulted in other non-iron ore based steel producers being treated on an equivalent basis to AMSA. As you will be aware, AMSA has previously been found to be "*super-dominant*" by the Competition Tribunal and accounts for more than 70% of domestic steel production.
14. Kumba recognises that promoting downstream beneficiation is one of the country's developmental objectives. It is quite clear that the previous "*cost-plus*" preferential treatment afforded to one mid-stream player is not supportive of downstream developmental objectives. A mechanism whereby value is transferred to one mid-stream player (AMSA) results in differential treatment for other mid-stream players (i.e. they are not treated equivalently as they do not rely on the same input materials) and does not result in the transfer of value to downstream players. As such, Kumba believes that it is important (involving all relevant participants in the steel value chain, including other suppliers of raw material such as Assmang, Burk, Sedibeng, Palabora and the suppliers of scrap steel and the other primary and secondary steel producers), to find a mechanism to support downstream beneficiation which does not distort the market and

<sup>1</sup> It should be noted that Highveld has a unique process which is predicated on the processing of vanadium rich iron ore from its Mapochs mine.

does not simply transfer a financial benefit from one upstream player to one mid-stream player.

15. Kumba believes that the crucial issue in achieving sustainable downstream development is to ensure that each level of the supply chain is "*healthy*" (meaning that it is sustainable), that participants in each level are treated equivalently and that no preference is extended to any one player. To the extent that nascent manufacturers require support, this should be achieved through direct and measurable support, which will in turn permit the Government to ensure that the relevant manufacturer develops into a sustainable and competitive entity.
16. I believe that these introductory remarks are important in setting the context for the answers, set out in Appendices A and B.
17. Kumba is cognisant of the national developmental objectives detailed in IPAP2 and is committed to playing its role in achieving these objectives.
18. Kumba welcomes all opportunities to engage with the Committee.

Yours sincerely

**Tebello Chabana**  
Executive Head: Public Affairs



**APPENDIX A**
**QUESTIONS RAISED IN YOUR LETTER DATED 13 AUGUST 2010**
**Question 1:**

*“Do you think that cancelling the cost plus 3% iron ore pricing agreement is still supportive of national developmental objectives including the support of downstream manufacturing industries”.*

1. There was no cancellation of the agreement. The agreement lapsed as a result of AMSA failing to convert its old order mining right.
2. In any event, AMSA has historically priced its steel on the basis of international steel prices and not on the basis of domestic input costs. As such, the benefit of the heavily discounted price at which iron ore was supplied by Kumba to AMSA was not passed on to beneficiaries in South Africa and did not support any national developmental objectives. As AMSA has not historically passed on any of the benefit received under the now lapsed cost plus 3% supply arrangement, there is no reason to believe that the lapse of this agreement will have any effect on domestic steel prices and hence any effect on downstream development. In any event, it is clear from AMSA's reported financial results that even if it had paid market linked, international iron ore prices, less the cost of transport from SA to export markets i.e. export parity prices (EPP), AMSA would still have been very profitable over the steel cycle. Historically AMSA has achieved significantly higher profits than its international peers. This profit has accrued to its shareholders and not to the local downstream industry. This can be seen from the following graph.



3. The preferential prices which AMSA has historically received have had the effect of distorting the market. In this regard, it should be noted that the other steel producers, which rely on other inputs (such as scrap steel) have not enjoyed any such advantages and procure their inputs at market related prices. This is particularly the case for the scrap based steel producers, which purchase scrap at export parity related prices. Kumba believes that the lapsing of the former supply agreement is likely to lead to a healthier steel industry, as it will remove one of the significant inequalities in relation to the steel industry in South Africa and effectively create a more level playing field; which should ultimately foster competition.

**Question 2:**

***“How does Kumba see the interim pricing agreement supporting the implementation of IPAP2, which requires substantial volumes of steel at competitive pricing for its success?”***

4. The interim agreement provides for:
  - a. A secure supply of iron ore volumes; and
  - b. Supply of iron ore at a significant discount to current market prices.
5. Based on information provided by AMSA to Kumba, the pricing under the interim agreement enables AMSA's plants to remain viable, some at a significant profit.
6. However, the price at which iron ore is supplied to AMSA does not have any beneficial impact on the price at which steel is supplied to South African steel users. Kumba believes that the emergence of a healthy and sustainable steel industry is the most effective means of ensuring sustainable downstream activity. The other steel producers that compete with AMSA in South Africa continue to produce steel, notwithstanding the fact that they procure their inputs at market related rates. Many of these steel producers are also involved in downstream beneficiation.
7. IPAP II needs to be pursued through a holistic strategy that addresses any restrictions in the steel value chain, including issues such as logistical constraints and the cost of electricity.

**Question 3:**

***“In the case that the iron ore price renders the steel industry (and downstream manufacturing) unviable, what would Kumba do with excess iron ore, i.e. how does Kumba intend contributing towards the beneficiation strategy?”***

8. Kumba is cognisant of Government's broader national developmental objectives and the requirements of IPAP II and will co-operate with Government in identifying reasonable and practical opportunities for promoting the objectives of IPAP II.
9. Kumba does not believe that its proposed increase in the price of iron ore would have a material impact on AMSA's pricing or reduce the domestic demand for iron ore:
  - a. The price at which Kumba has historically supplied iron ore to AMSA has had no impact on the price at which AMSA supplies steel to end users in South Africa. AMSA has always supplied steel on the basis of international prices;
  - b. The other steel producers in South Africa (and their downstream customers) remain viable, notwithstanding the fact that they do not source their iron ore requirements at significantly discounted market prices such as AMSA has done in the past;
  - c. Kumba has not suggested and is not suggesting that it wishes to sell iron ore at a price above EPP, whereas AMSA sells its products at a price linked to IPP; and
  - d. In any event, on the basis of a historical analysis, even if AMSA were to have acquired its iron ore from Sishen on an export parity basis, it would still have been significantly profitable in the period 2001 to 2010 and would have made returns which were in line with those of international steel producers.

10. Accordingly, Kumba does not believe that there is likely to be any domestic "excess" of iron ore.

**Question 4:**

***"If SA was able to attract another player in the steel industry, would Kumba support such a process and if so how particularly in relation to access to iron ore and pricing thereof?"***

11. In principle, Kumba would welcome the establishment of a new steel producer in South Africa. This would enable domestic iron ore players to potentially increase their levels of production (and increase levels of employment) in order to meet the increased domestic demand. Kumba has, through active research and development partnerships with entities such as Mintek, the IDC and IMBS, encouraged finding a means to attract new entrants into the steel sector. Kumba has also been evaluating a number of proposals to progress beneficiation and to enhance the global competitiveness of the South African steel industry. In this regard, it is currently in discussions with the IDC, Seven Star Huludao, Tata and IMBS to assess the viability of new technologies. It should, of course, not be forgotten that there are currently five other steel producers in South Africa and care should be taken that any intervention does not distort the market, by favouring one producer, as this provides a disincentive to potential new entrants into the steel industry and to expansion of production capacity by the existing steel producers.
12. Kumba could assist the establishment of a new steel producer through:
- Providing a secure supply of high quality iron ore at market related prices;
  - Assisting any new entrant with technology selection; and
  - Contributing funds for test work and technological evaluation.
13. Kumba believes that the lapsing of the supply agreement, which conferred a significant cost advantage on AMSA, will also increase the possibility of being able to attract a new entrant into the South African steel industry.

**Question 5:**

***"How do you think we can ensure the viability and cost competitiveness of local steel production while ensuring that a competitive steel pricing regime supports the development and deepening of value-added manufactured products in downstream industries?"***

14. Kumba believes that it is critical that each level of the supply chain should be sustainable and healthy and that this is the best mechanism to ensure that the steel industry supports the development of value-added manufactured products in downstream industries. All four steps of the iron and steel value chain (exploration & extraction, mining beneficiation, metallurgical beneficiation & shaping, and manufacturing & conversion) need to be sustainable and need to operate in an environment that encourages growth. Market principles should apply to avoid distortions in the industry structure and to enable profitable investment that does not negatively impact growth in SA or international investor sentiment.
15. This objective will not be achieved through seeking to provide preferential pricing to one mid-stream player, as such "subsidies" simply result in unforeseen distortions. AMSA has received Sishen iron ore at significantly discounted prices over the past nine years and this has not resulted in any benefit to downstream industries. Should Government wish to



support downstream industries, a means should be found to provide targeted subsidies to the specific manufacturers which the Government believes require support.

16. The significant advantage, which AMSA has enjoyed as a result of the preferential basis on which it has previously obtained iron ore, simply increased the other significant advantages which AMSA enjoys over its other domestic competitors, including its scale and the range of products that it produces.

**Question 6:**

*“How do you intend contributing to government's vision that aims to ensure that SA's comparative advantage in the form of abundant mineral resources is used to develop the economy rather than being captured by upstream producers?”*

17. Kumba is a significant player in the South African mining sector and has the benefit of access to significant resources which it mines optimally and responsibly.
18. To the extent it is able to extend the scope of its mining operations, Kumba is doing so, with attendant benefits such as job creation. Kumba is making a substantial investment in new iron ore projects and is targeting production of 53Mtpa by 2013 and 70Mtpa by 2019. New projects include:
  - a. Kolomeia (total capex is expected to be R8.5bn):
    - i. Full production of 9Mtpa in 2013; and
    - ii. Permanent employment for a further c.800 people;
  - b. Thabazimbi's Project Phoenix will use new methods to mine banded iron ore formations and beneficiate this through a Jig plant producing c. 3.5Mtpa; and
  - c. A new open pit mining operation is being developed at Zandriverspoort with potential production of 1 – 5Mtpa.
19. In addition, Kumba is focused on several significant initiatives that will assist in the development of the South African economy:
  - a. Kumba's Enterprise Development spend has generated revenues of R54m and created 250 permanent jobs over the last 24 months. Through its enterprise development initiatives, the Anglo American group, including Kumba, are focused on creating 25,000 new jobs over a seven year period (2008 – 2015);
  - b. in 2009, Kumba spent R90.4m (in excess of 5% of payroll) on skills development and currently has 725 apprenticeships (approximately 15% of South Africa's total mining sector apprentices); and
  - c. In 2009, R3.2bn was spent on preferential procurement.
20. Kumba is also involved in a number of downstream beneficiation projects. In this regard, it is engaging with the IDC and the DTI. Kumba believes that downstream development will be facilitated through the assessment of viable new technologies, which are suitable to South Africa's ore quality and the development of low grade input factors, which will improve the likelihood of new steel producers being established in South Africa.
21. In addition, Kumba also believes that the development of the Limpopo iron ore deposits could facilitate the entry of a new steel producer. In this regard, Kumba proposes



participating with the Government and the South African steel producers in a comprehensive Government co-ordinated research programme.

22. Kumba looks forward to engaging with the inter-departmental task team to exchange ideas on how to encourage downstream manufacturing through
  - a. Ensuring that the steel value chain is not characterised by any distortions; and
  - b. Finding a means to ensure that the Government is able to direct support to specific players that merit support and who are able to demonstrate a viable long term proposition.

**Question 7:**

*"The original intent of government in the Iscor/Kumba unbundling process, namely:*

- *To ensure the viability and cost-competitiveness of local steel production, and*
- *To ensure a competitive steel pricing regime to support the development and the deepening of value-added manufactured products in downstream industries.*

*In this regard can Kumba identify all measures and instruments that can be deployed to a value-chain approach to the situation which culminates in the competitive steel pricing to support downstream products and hence jobs and value-added"*

23. If the iron ore and steel value chain is broken down into its component parts, each participant in that value chain has a role to play. Kumba is committed to playing its role to the best of its capability and in a manner that benefits the overall value chain.
24. Kumba through its exploration, extraction and mining beneficiation activities contributes a very significant portion of both the current and future growth in value-add for the entire iron ore and steel value chain.
25. In addition:
  - d. Kumba is evaluating new iron ore developments that could be used as a source of supply to new entrants; and
  - e. Kumba has engaged with several international steel producers on their potential entry into South Africa.
26. These measures should assist Government in creating a sustainable downstream sector.
27. Moreover, Kumba has already been involved in a number of beneficiation projects and research and development projects to support beneficiation throughout the steel value chain.
28. Kumba is currently engaging with the inter-departmental Government Task Team regarding mechanisms to stimulate downstream development. Kumba believes that an enabling beneficiation regime requires an enabling framework, which involves skills development and a re-appraisal of the relevant regulatory framework. It will also require engagement with the providers of other inputs including electricity, water, transport and scrap.



29. Kumba believes that a sustainable downstream manufacturing industry is premised on an efficient supply chain which is not characterised by distortions or subsidies as these simply promote inefficiency and have unforeseen consequences. To the extent that downstream manufacturing requires support, this should be achieved through direct support as opposed to seeking to achieve this goal through subsidised pricing to one mid-stream steel producer which results in the creation of an unequal playing field and does not actually benefit downstream beneficiaries.

**Question 8:**

***“What pricing regime is Kumba Iron Ore currently applying for other domestic steel manufacturers?”***

30. It should be noted that the other domestic steel producers are principally configured to produce steel from scrap (Scaw, Cape Gate, CISCO and SA Steelmakers) or vanadium rich iron ore (Highveld). As such, there is a very limited domestic demand for iron ore from the Sishen Mine other than from AMSA. However, to the extent that other steel producers purchase iron ore from Kumba, it sells to them on the basis of market related prices (with the result that, even under the interim pricing arrangements, AMSA still procures its iron ore at a considerable discount to these other steel producers).
31. In addition SIOC sells the majority of its iron ore at global prices to steel facilities which are located throughout the world.

**APPENDIX B**

Questions which were raised by the Parliamentary Portfolio Committee at the engagement on 13 August 2010 and which were not fully answered

**Question 1:**

*"When was the supply agreement with AMSA due to come to an end?"*

1. The supply agreement, which was premised on AMSA's possession of a mining right, had a 25 year duration (i.e. 1 July 2001 until 30 June 2026), subject to the termination provisions contained in the agreement and conditional upon AMSA maintaining its mining rights in relation to the Sishen properties. The supply agreement lapsed as a result of AMSA's failure to convert its old order 21.4% undivided mining right in the Sishen Mine.

**Question 2:**

*"What is Kumba's role in the industrialisation of SA?"*

2. Kumba mines and beneficiates iron ore. This is then sold to steel producers (export as well as domestic sales) for use by downstream users in industrial applications. As has been discussed above, Kumba is involved in a number of initiatives to explore the development of domestic indigenous technology for the use of South African specific inputs.

**Question 3:**

*"What are the opportunities for BEE mining in the Northern Cape area?"*

3. SIOC is an empowered company and has amongst its BEE shareholders a broad based community trust as well as an employee trust. These trusts will benefit from the continued expansion of SIOC's activities in the Northern Cape including its beneficiation activities through the jig plant which it has installed at the Sishen Mine. In addition, these trusts and SIOC's other empowerment partner, Exxaro, have benefited significantly as a result of their participation in SIOC since 2006.
4. There are also a number of smaller projects in the Northern Cape which are being developed by empowered entities (for example Sedibeng and Burk Mining).

**Question 4:**

*"Give more detail re employment equity statistics:"*

- **Management**
- **How many black engineers (current / past)?**
- **Contribution to engineering skills development**

**Employment Equity Status Report at Kumba**

5. Kumba has a three year employment equity strategy. Internal equity targets for 2010 have been set and these align to its employment equity strategy. Kumba has already exceeded the Mining Charter target of 40% at management level. To date, Kumba's representation at Management Level is 45.85% against a target of 48.63%. Specific targets have been set for improving presentation of black people at management levels and the progress to date.

is 31% against a target of 35%. It is the intention of Kumba to drive transformation beyond compliance requirements.

***Historical performance in the development and employment of Black Engineers at Kumba***

6. The development of technical talent is one of Kumba's key strategic priorities. In 2007 Kumba had a total of 44 HDSA engineers and has grown this to a total of 83 HDSA engineers to date. Excluding white women, Black engineers have grown from 39 to 74 engineers to date.

***Contribution to Engineering Skills Development***

7. Kumba operates two accredited training centres based at the Sishen and Thabazimbi Mines. These two centres train artisans from a broad technical spectrum and also supply artisans to neighbouring mines in the Northern Cape. Out of the learner pool, Kumba aims to produce 140 competent artisans on an annual basis. 80% of these learners are HDSAs. The focus on technical skills development specifically at the training centres, is based on both Kumba's and the neighbouring mines' technical requirements. These centres produce amongst others millwrights, fitters, electricians, boilermakers, welders, platers etc.
8. Kumba aims to have 140 qualified artisans per annum from its learnership pool. Kumba provides training in portable skills such as carpentry, bricklaying, welding and plumbing to the communities. 204 learners from the community will be trained at our Kathu Community Training Centre (Tshipi). At Thabazimbi 129 learners from the community will be trained on various portable skills, including motor mechanic skills.

***Bursary and Scholarships***

9. Currently Kumba has 70 bursars in the bursary pool with 33% female and 79% HDSA representation. 70 engineering bursars have been awarded in 2010. 78% of these bursaries were awarded to HDSA's and 33% were awarded to women. The majority of bursaries awarded related to mining, metallurgical and geosciences disciplines.
10. 5.6% of Kumba's payroll has been spent on skills development up to the end of June 2010. Out of this, 13.5% has been spent on artisan training and 29.4% on bursars and professionals in training.

***Question 5:***

***"Did you apply for 100% of the rights?"***

11. In 2005, SIOC applied for a conversion of its 78.6% old order undivided mining right, which was granted in 2008. On 1 May 2009, SIOC applied for the residual 21.4% undivided mining right. In terms of its granted mining right, SIOC mines the whole of the Sishen Mine.