# FINANCIAL REVIEW

**Mike Arnold** Financial Director

## Overview

ARM achieved headline earnings of R2 317 million (headline earnings per share of 1 094 cents) in a most challenging year, which included a massive global crash in commodity prices and demand, as compared to the R4 013 million recorded for the year ended 30 June 2008 (headline earnings per share of 1 906 cents). The year's results were, in addition, negatively impacted by significantly increased costs at TEAL and a negative contribution from the platinum segment. Notwithstanding the decline, the cumulative annual growth rate in headline earnings since June 2004 was 118%.

The average Rand/US Dollar exchange rate at R9.03/US$ for the year to June 2009 reflects a 24% weakening over the 2008 average of R7.30/US$, which has to some extent compensated for lower US Dollar commodity prices.

Basic earnings for the year were R2 868 million (basic earnings per share of 1 355 cents); R551 million more than headline earnings, largely as a result of a R557 million exceptional gain accounted for on the sell down of ARM's stake in TEAL to 50% and the introduction of Vale as a 50:50 partner. The basic earnings for the year to June 2008 were R4 487 million (2 131 cents per share).

The major contributor to ARM's headline earnings for F2009 was the Ferrous Division where the contribution increased by 14% to R3 150 million (F2008: R2 775 million). This was the only division to reflect an increase, which was mainly driven by a strong result from iron ore while manganese ore performed very well until October 2008.

The Platinum Division's contribution (inclusive of Nkomati) to headline earnings reflected a decrease of R1.6 billion from the F2008 profit of R1.3 billion to a F2009 loss of R0.3 billion. Average PGM basket prices fell by more than 32% during the year. The Nkomati Nickel Mine's contribution fell to R29 million as compared to R432 million for F2008, mainly due to chrome sales virtually ceasing for the period October 2008 to April 2009. Average US Dollar nickel prices fell by 53% for the year. Included in the loss for the year was a R547 million realised loss on the 30 June 2008 debtors as the provisional prices used to value debtors, at 30 June 2008 realised at significantly lower prices in the first half of F2009.

The contribution from Coal decreased to R135 million (F2008: R175 million) as a result of lower prices and a number of operational issues which affected results in the second half of the financial year. ARM corporate and other contributed R40 million (F2008: loss R73 million).

The consolidated loss for the ARM Exploration division (TEAL) increased to R689 million from a loss of R211 million in F2008, largely due to the following increases in expenses and restructuring costs:

- stock write downs: R103 million;
- cancellation of mining contracts at Kalumines in the Democratic Republic of Congo (DRC): R87 million;
- fluctuation of the Rand/US Dollar exchange rate, TEAL's functional currency being US Dollars: R87 million;
- interest paid: R30 million; and
- increased mining losses at Kalumines: R112 million.

The benefit of needing to account for only 50% of TEAL, after the closing of the transaction with Vale, in terms of accounting conventions, only commenced in March 2009.

The unaudited profit variance analysis below clearly indicates how ARM's results were impacted by various factors during the year.

## Cash and borrowings

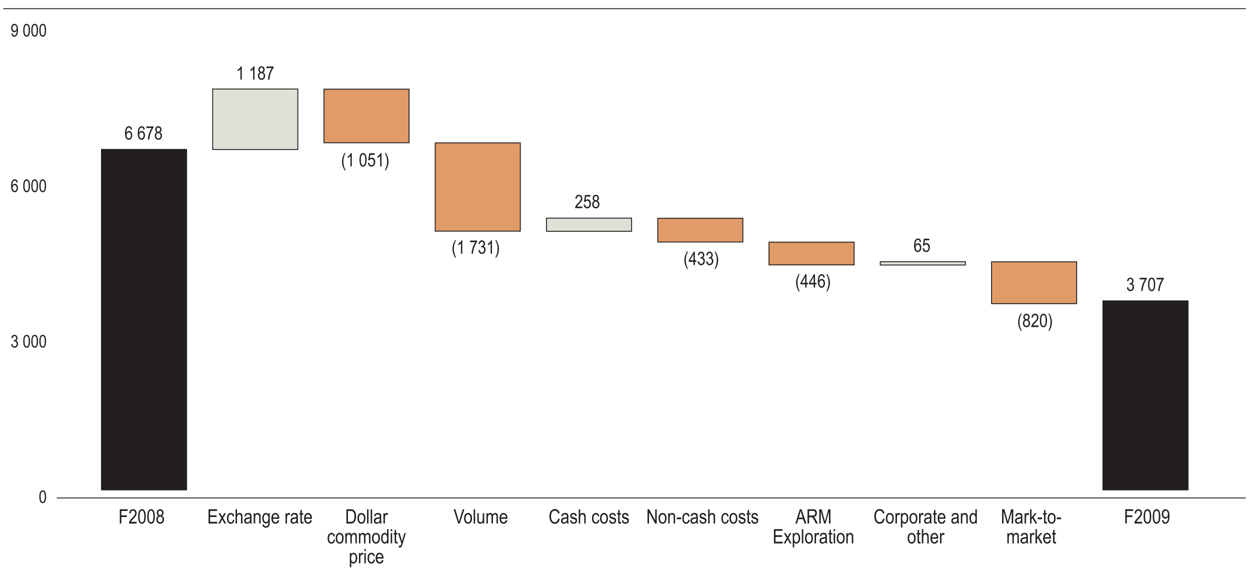
ARM responded promptly to the global economic downturn by focusing on conserving cash and reducing debt at all operations. This was achieved by the immediate deferment of certain non-essential capital expenditure at all operations, operational cost reduction initiatives, significant production cuts at the ferromanganese and ferrochrome units and the application of surplus cash to eliminate bank debt at ARM Mining Consortium (Modikwa) and reducing the balance outstanding on the ARM corporate loan. In addition, at a Company level, ARM received dividend payments of R2.1 billion from ARM Ferrous (this division reflected an attributable cash balance at year end of R1.6 billion).

There was an improvement of R1.1 billion in the ARM net debt position at 30 June 2009 to R231 million from the position at 30 June 2008 of R1 318 million. This significant improvement

### Contribution to headline earnings by segment

| Commodity group | 12 months ended 30 June | | |
|---|---|---|---|
| **R million** | **F2009** | **F2008** | **% change** |
| Platinum Group Metals | **(348)** | 915 | >(100) |
| Nkomati nickel and chrome | **29** | 432 | (93) |
| Ferrous metals | **3 150** | 2 775 | 14 |
| Coal | **135** | 175 | (23) |
| **Sub-total** | **2 966** | 4 297 | (31) |
| Exploration: TEAL | **(689)** | (211) | >(100) |
| Corporate and other | **40** | (73) | >100 |
| **ARM headline earnings** | **2 317** | 4 013 | (42) |

**Profit variance analysis (unaudited) – profit from operations before exceptional items**
(R million)



## Summarised income statement

| R million | F2009 | F2008 | % change |
|---|---|---|---|
| | 12 months ended 30 June | | |
| Sales | **10 094** | 12 590 | (20) |
| Profit from operations (before exceptional items) | **3 707** | 6 678 | (44) |
| Income from investments | **414** | 168 | 146 |
| Finance costs | **(385)** | (438) | 12 |
| Income from associate* | **147** | 461 | (68) |
| Exceptional items | **514** | 162 | 217 |
| Taxation | **(1 727)** | (2 084) | 17 |
| Minority interest | **198** | (460) | 143 |
| Profit after tax and minorities | **2 868** | 4 487 | (36) |
| Headline earnings | **2 317** | 4 013 | (42) |
| Headline earnings per share (cents) | **1 094** | 1 906 | (43) |
| Dividends per share declared after year end | **175** | 400 | (56) |
| EBITDA | **4 484** | 7 229 | (38) |

* *Exceptional profit of R317 million included in F2008; F2009 includes R27 million.*

## Summarised balance sheet

| R million | F2009 | F2008 |
|---|---|---|
| | At 30 June | |
| **Non-current assets** | **18 566** | 16 802 |
| Property, plant, equipment and other | **12 138** | 9 449 |
| Investments | **6 428** | 7 353 |
| **Current assets** | **6 933** | 8 076 |
| Other | **3 420** | 5 416 |
| Cash and equivalents | **3 513** | 2 660 |
| **Total assets** | **25 499** | 24 878 |
| Shareholders' interest | **16 751** | 15 676 |
| Non-current liabilities: | | |
| Long-term borrowings | **1 364** | 2 254 |
| Other | **2 678** | 2 478 |
| Current liabilities: | | |
| Short-term borrowings | **2 380** | 1 724 |
| Other | **2 326** | 2 746 |
| **Total shareholders' interest and liabilities** | **25 499** | 24 878 |

was achieved while still continuing with expansion capital expenditure at the Nkomati Nickel Mine, Goedgevonden Coal Project, ARM Ferrous and at Two Rivers. The debt on the balance sheet includes an amount of R1.8 billion advanced by our partners (Implats: R539 million; Angloplats: R132 million; Xstrata: R1 135 million).

Since the year end the ARM corporate loan of R967 million has been refinanced and the new facility increased to R1.75 billion with a maturity in August 2012. ARM and its partner at Nkomati, Norilsk Nickel, have decided to fund the completion of the Phase 2 expansion project utilising their respective corporate balance sheets, given the current restrictive lending environment.

## Consolidated income statement

Sales revenue decreased by R2.5 billion to R10.1 billion (a decrease of 20% over F2008). The decline in sales was primarily in the Platinum Division where PGM and nickel prices fell substantially during the year, while the Ferrous Division's sales actually reflected an increase of 3% to an attributable R7.7 billion from the R7.4 billion recorded in F2008. Sales volumes were lower in all commodities other than iron ore and PGMs.

Cost of sales increased by 10% in absolute terms. The main factors behind this increase were:

- Cost rationalisation programmes only made a positive contribution to costs from Q4;
- Amortisation increased by 45% or R246 million largely as a result of production ramp-ups at Khumani and Two Rivers;
- Various costs increased well ahead of CPIX during the year. These included electricity, fuel, consumables such as coke, as well as steel;
- Production increases at Khumani; and
- Mining cost inflation, albeit down from F2008, is still currently between 10% and 15% as a result of these cost increases.

With the fall in sales revenue and cost increases during the year, the average gross profit margin decreased to 40%, compared to 56% in the previous year.

Other operating income increased to R916 million from R460 million in F2008. This increase was mainly due to the inclusion of R100 million from proceeds on the partial settlement of the Cato Ridge insurance claim as well as increased foreign exchange gains following the weakening of the Rand against the US Dollar during the year.

Other expenses mainly comprised non-operational costs at ARM Company, Assmang and TEAL. Other operating expenses increased by R399 million to R1 255 million, largely due to much higher costs at TEAL and increased shortworkings costs in ARM Ferrous resulting from smelter shutdowns.

Due mainly to the decline in sales and the increase in costs attributable to TEAL, profit from operations before exceptional items decreased 44% to R3.7 billion in F2009 from R6.7 billion in F2008.

Investment income, which comprises interest received on favourable bank and cash balances, increased by R246 million in the year to R414 million, which resulted from increased cash and bank balances principally at ARM and ARM Ferrous. This was achieved notwithstanding the approximately 4% fall in interest rates during the year. Total cash and bank balances increased by R853 million during the year to R3.5 billion.

Finance costs decreased slightly, by R53 million, largely due to the fall in interest rates during the year. Gross borrowings remained flat at between R3.8 billion and R4.0 billion for the year.

The effective taxation charge for the year increased to 39.2% from 29.6% for F2008. The increase was largely attributable to (i) increased secondary tax on companies arising from the dividends paid by ARM Ferrous during the year, and (ii) significantly increased ARM Exploration costs which were non-deductible. This charge is reduced by the non-taxable exceptional items included in the results. In addition, associate income which is shown net of tax influences the tax charge. A full tax charge reconciliation is provided under note 28 to the financial statements.

Earnings before interest, tax, depreciation and amortisation, excluding exceptional items and income from associate (EBITDA) decreased by R2.7 billion to R4.5 billion in F2009. The EBITDA margin for F2009 was lower at 44%, compared to 57% in F2008. Project investment continues as ARM's balance sheet remains strong with low gearing, even after R3.3 billion capital expenditure in F2009. The corporate action undertaken during the year has further enhanced the value of ARM's operations.

## Consolidated balance sheet

The ARM balance sheet remained robust despite the fall in commodity demand as operations focused on preserving cash during the second half of the financial year. The net debt to equity ratio decreased to 1% (at 30 June 2008: 8%).

Included in borrowings are loans from partners amounting to R1.8 billion which, if disregarded, would result in ARM having a net cash position of R1.6 billion at 30 June 2009, as compared to a net cash position on the same basis at 30 June 2008 of R174 million.

**Additional key features of the balance sheet include:**

- Property, plant and equipment increased by R2.5 billion, mainly due to attributable capital expenditure of R3.3 billion with the largest expenditure being at ARM Ferrous where ARM's share was R1.3 billion. This expenditure mainly related to the completion of the plant at the Khumani Mine. Expansion capital was also expended at Two Rivers on plant upgrades, at Nkomati on the Phase 2 expansion project and on the completion of the Goedgevonden Coal Mine.
- Other investments mainly comprised ARM's 14.9% stake in Harmony. This investment was marked-to-market at R80 per share on the balance sheet at 30 June 2009. Changes in the value of the investment are accounted for net of deferred capital gains tax through the statement of changes in equity. At 25 September 2009, the applicable share price was R78.01 per share.
- Current assets excluding cash and cash equivalents decreased by R2.0 billion largely owing to the decreased level of accounts receivable at the year end. A significant realised adjustment to the platinum and nickel divisional debtors at 30 June 2008 of R547 million was made in F2009 as a result of the realised value being less than the provisionally recognised value at 30 June 2008.
- Gross interest-bearing borrowings decreased marginally to R3.8 billion at 30 June 2009. The major changes during the year were (i) the increased attributable borrowings at ARM Coal to fund the development of the Goedgevonden Coal Project, (ii) the ARM Mining Consortium bank loan which was repaid in December 2008, and (iii) TEAL borrowings which are now proportionately consolidated whereas previously these were included at 100% when TEAL was a subsidiary of ARM.
- Trade and other payables increased by R120 million to R1.6 billion.

## Cash flow statement

Cash flow from operating activities decreased marginally by R119 million to R4.1 billion for the year as compared to R4.2 billion for F2008. This represents a decrease of 3% over F2008. There has been a reduction of approximately R2 billion in working capital offset by higher tax and dividend payments.

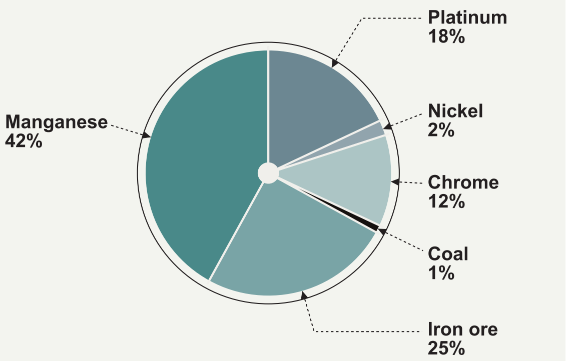
Cash flow related to investing activities remained high, with capital expenditure being the main component. Capital expenditure to maintain operational production amounted to R0.9 billion while expansion capital was R2.3 billion. There was no material change to the cashflow from financing activities as the overall level of borrowings was maintained during the year. Since the year end the bank debt in TEAL was repaid by the partners.

The closing cash position of R3.5 billion (at 30 June 2008: R2.7 billion) was held primarily at ARM Ferrous (R1.6 billion, at 30 June 2008: R1.4 billion) and at ARM Company (R1.2 billion, at 30 June 2008: R0.3 billion).

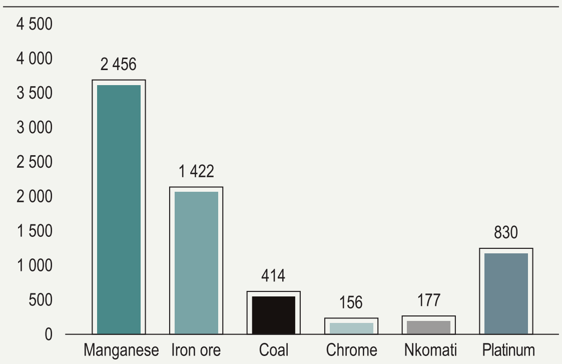
## Segmental analysis

The graphs and charts on pages 148 to 149 indicate certain key elements of the segmental contributions to the ARM results. In addition, detailed segmental results are provided on pages 162 to 168 of the financial statements.

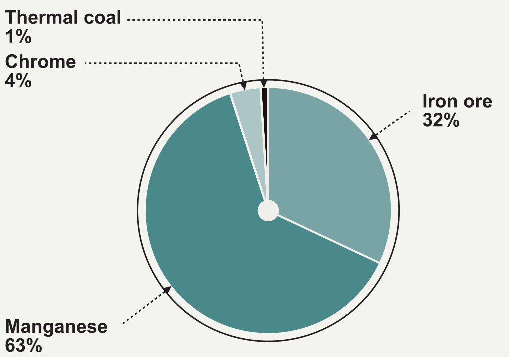
**F2009 revenue contribution per commodity**




**F2009 cash flow from operating activities**
(R million)




**F2009 attributable EBIT (excluding ARM Platinum, ARM Exploration and Corporate and other)**




## Capital expenditure

ARM continued to invest in capital projects in the year and has spent an attributable R3.3 billion in F2009 as compared to R2.8 billion in F2008.

Looking forward, ARM is forecasting to spend more than R8 billion over the next three years on three main projects:

- Khumani Iron Ore Mine expansion to 16 mtpa; with attributable capital expenditure of R3.3 billion. The project will be financed out of internally generated cash flows and existing cash and borrowing facilities in ARM Ferrous.
- Completion of the Nkomati Phase 2 expansion. The required funding is to be provided by the partners.
- Completion of the Goedgevonden Coal Mine. Funding for this mine is being provided by Xstrata.

The development of copper assets at Konkola North in Zambia in the Vale/ARM joint venture is under consideration.

## Accounting policies

ARM presents its financial information in compliance with International Financial Reporting Standards (IFRS). The financial information for the year ended 30 June 2009 has been prepared adopting the same accounting policies used in the most recent Annual Financial Statements, except for the adoption of various new and revised IFRS standards where applicable.

## Financial risks

In the course of its business operations ARM is exposed to currency, commodity price, interest, counterparty, credit and acquisition risk.

*A detailed analysis of ARM's approach to these risks is provided on pages 189 to 194 of the financial statements. A sensitivity analysis is provided on pages 191 to 192 of the Annual Financial Statements.*

## Significant accounting matters

A portion of the insurance claim relating to the furnace explosion at the Cato Ridge Works, claimable against the overseas reinsurers, was settled during the year. This represents 60% of the claim. ARM Ferrous received a payment of R240 million in April 2008 and accounted for this amount as follows: R200 million related to business interruption cover was accounted for in other income and the balance was treated as an exceptional recovery on the refurbishment of the furnace.

In February 2009, the toll treatment agreement for Modikwa was renegotiated with an effective date of 1 December 2008. The new agreement improves recoveries for Modikwa and is included in its results from that time. At the same time an agreement was reached whereby Anglo Platinum contributes to the funding which was required of the communities in the development of the mine. This funding has previously been provided by ARM. Anglo Platinum has accordingly lent R132 million to ARM Mining Consortium, enabling it to repay a portion of the loan owing to ARM.

The ARM transaction with Vale has resulted in TEAL becoming a proportionately consolidated incorporated joint venture.

## Dividend

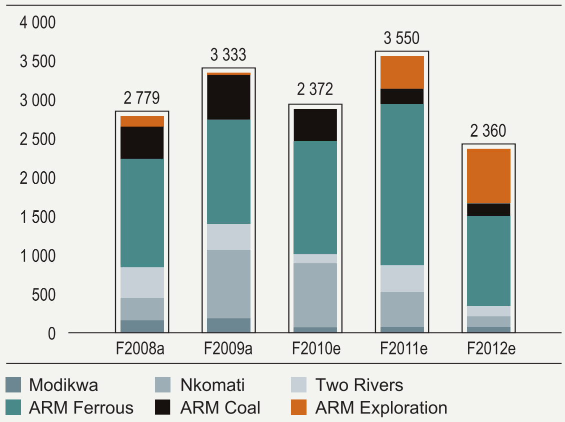
Dividends are declared after consideration of the solvency and liquidity of the Company and with due regard to the current funding status of the Company, future funding requirements and attributable cash flows.

The continued growth in ARM's net cash position, excluding partner loans, has been achieved by prudent cash management despite the economic downturn. The recovery of market demand and prices is expected to be gradual and as a result the current cash position provides a solid base going forward. ARM had minimal gearing at 30 June 2009 and has sufficient cash and borrowing resources to fund continuing capital expenditure for both the maintenance and expansion of operations. Despite early signs of improvement in markets it is not yet clear as to the exact pace of recovery going forward. As such, ARM will continue to review Company plans and forecasts every quarter.

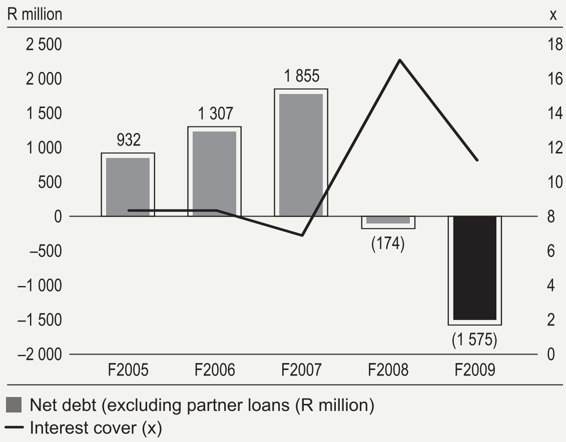
Accordingly, the Board of Directors declared its third dividend of 175 cents per share on 31 August, payable on 28 September 2009. The amount paid was approximately R371 million. This declaration of a dividend reflects the strength of the ARM cash position while the Board maintains its prudent approach in the current economic environment.

**Mike Arnold**
*Financial Director*
7 October 2009

**Capital expenditure**
(R million)




**Net debt/(cash) – excluding partner loans and interest cover**




**Cash on balance sheet and dividends**
(R million)