

Equities

10 February 2012 | 24 pages

Kumba Iron Ore Ltd (KIOJ.J)

Valuation Stretched and Margins Unsustainable - Sell

- Company Update
- Target Price Change
- Estimate Change

- **Target price cut 4% to R430** — Following Kumba's weaker than forecast FY11 results, we reduce earnings forecasts over the next five years up to 4% as we incorporate higher costs. We also reduce our target price 4% to R430.
- **Volumes are growing** — Management guided that 2012 export volumes could grow by ~3Mt (7%) as Kolomela ramps up. Kumba's 2019 South African production target of 70Mt (70% growth from 2011) remains unchanged, but sounds overly ambitious to us given its limited resource base, potential infrastructure constraints and the fact that no project beyond Kolomela has been approved yet. Kumba's next generation of projects are likely to involve expensive beneficiation or lower quality product (lower realisations), in our view.
- **But margins could be waning** — Margins may have peaked in 2011, unless iron ore prices keep rising. Costs are escalating rapidly, mainly due to increasing mining complexity. Sishen's stripping ratio could rise from 2.6x to 3.7x by 2014. Management guided that unit costs could increase 10%p.a., excluding inflation as a result.
- **Potential for poor capital allocation** — We are sceptical of Kumba's potential African growth strategy given: 1) previous experience with Faleme, 2) significant infrastructure challenges, 3) peak cycle asset prices, 4) questionable quality of available deposits (magnetite/concentrate product).
- **Sell maintained** — We remain cautious on Kumba due to: 1) Strong recent share price rally 2) lack of visibility on production growth beyond Kolomela, 3) declining iron ore prices, 4) pressure on costs due to increasing mining complexity, and 5) potential for poor capital allocation (African growth strategy). We prefer Assore (TP R280, BUY) with 40% near term iron ore growth and a more attractive valuation for iron ore exposure. Our target price for Kumba of R430 offers a negative total one-year return of 14%.

Sell	3
Price (09 Feb 12)	R552.34
Target price	R430.00
	from R450.00
Expected share price return	-22.1%
Expected dividend yield	8.3%
Expected total return	-13.8%
Market Cap	R177,886M
	US\$23,534M

Price Performance (RIC: KIOJ.J, BB: KIO SJ)



Kumba Iron Ore Ltd (ZAR)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (RM)	38,704.0	48,553.0	54,454.8	57,405.4	55,240.8
Net Income (RM)	14,328.0	17,048.0	18,817.1	19,117.5	17,035.6
Diluted EPS (R)	44.54	52.99	58.32	59.25	52.80
Diluted EPS (Old) (R)	44.54	55.38	60.08	61.61	53.56
PE (x)	12.4	10.4	9.5	9.3	10.5
EV/EBITDA (x)	7.0	5.5	5.1	5.2	5.7
DPS (R)	34.50	44.20	50.00	54.00	49.00
Net Div Yield (%)	6.2	8.0	9.1	9.8	8.9

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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KIOJ.J: Fiscal year end 31-Dec						Price: R552.34; TP: R430.00; Market Cap: R177,886m; Recomm: Sell					
Profit & Loss (Rm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	38,704	48,553	54,455	57,405	55,241	PE (x)	12.4	10.4	9.5	9.3	10.5
Cost of sales	-13,367	-16,218	-19,345	-22,894	-24,522	PB (x)	12.4	11.2	8.8	8.3	8.2
Gross profit	25,337	32,335	35,109	34,512	30,718	EV/EBITDA (x)	7.0	5.5	5.1	5.2	5.7
Gross Margin (%)	65.5	66.6	64.5	60.1	55.6	FCF yield (%)	8.3	12.5	11.8	13.7	12.3
EBITDA	25,896	32,963	35,938	35,523	32,068	Dividend yield (%)	6.2	8.0	9.1	9.8	8.9
EBITDA Margin (%)	66.9	67.9	66.0	61.9	58.1	Payout ratio (%)	77	83	86	91	93
Depreciation	-765	-997	-1,343	-1,557	-1,928	ROE (%)	132.4	113.0	104.1	91.7	79.1
Amortisation	0	0	0	0	0	Cashflow (Rm)	2010	2011	2012E	2013E	2014E
EBIT	25,131	31,966	34,595	33,966	30,140	EBITDA	25,896	32,963	35,938	35,523	32,068
EBIT Margin (%)	64.9	65.8	63.5	59.2	54.6	Working capital	-331	79	-3,104	193	294
Net interest	-29	92	-31	21	146	Other	-6,009	-5,066	-8,074	-8,224	-7,477
Associates	0	0	0	0	0	Operating cashflow	19,556	27,976	24,760	27,493	24,885
Non-op/Except	5	6	0	0	0	Capex	-4,723	-5,849	-3,810	-3,000	-3,000
Pre-tax profit	25,107	32,064	34,564	33,987	30,286	Net acq/disposals	-348	-164	-1,200	-500	0
Tax	-6,813	-9,760	-9,620	-8,497	-7,571	Exploration exp/Other	-18	-74	125	230	318
Extraord./Min.Int./Pref.div.	-3,966	-5,256	-6,127	-6,373	-5,679	Investing cashflow	-5,089	-6,087	-4,885	-3,270	-2,682
Reported net profit	14,328	17,048	18,817	19,118	17,036	Dividends paid	-6,699	-13,763	-14,332	-18,035	-17,391
Net Margin (%)	37.0	35.1	34.6	33.3	30.8	Financing cashflow	-9,598	-20,076	-18,649	-22,920	-25,796
Core NPAT	14,328	17,048	18,817	19,118	17,036	Net change in cash	4,870	1,813	1,227	1,303	-3,593
Per share data	2010	2011	2012E	2013E	2014E	FCF ex acquisns & explorn	14,485	21,963	19,750	23,993	21,885
Reported EPS (R)	44.54	52.99	58.32	59.25	52.80	Segmental Revenue (RM)	2010	2011	2012E	2013E	2014E
Core EPS (R)	44.54	52.99	58.32	59.25	52.80	Domestic sales	2,874	3,388	3,863	4,107	4,353
DPS (R)	34.50	44.20	50.00	54.00	49.00	Export sales	32,951	42,454	47,419	49,997	47,453
CFPS (R)	60.79	86.96	76.75	85.21	77.13	CIF revenue	2,879	2,711	3,173	3,301	3,435
FCFPS (R)	46.11	68.78	64.94	75.92	67.83	Sales - total segments	38,704	48,553	54,455	57,405	55,241
BVPS (R)	44.54	49.16	63.09	66.45	67.34						
Wtd avg ord shares (m)	321	321	322	322	322						
Wtd avg diluted shares (m)	322	322	323	323	323						
Growth rates	2010	2011	2012E	2013E	2014E						
Sales revenue (%)	65.3	25.4	12.2	5.4	-3.8						
EBIT (%)	95.1	27.2	8.2	-1.8	-11.3						
Core NPAT (%)	105.5	19.0	10.4	1.6	-10.9						
Core EPS (%)	104.7	19.0	10.1	1.6	-10.9						
Balance Sheet (Rm)	2010	2011	2012E	2013E	2014E						
Cash & cash equiv.	4,855	4,742	4,989	6,293	3,343						
Accounts receivables	3,096	3,537	5,679	5,458	5,146						
Inventory	3,102	3,864	4,047	4,465	4,736						
Net fixed & other tangibles	15,872	20,884	24,547	26,485	27,552						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	454	696	700	705	710						
Total assets	27,379	33,723	39,962	43,405	41,487						
Accounts payable	3,274	4,556	3,777	4,167	4,420						
Short-term debt	0	3,191	1,361	1,644	546						
Long-term debt	3,185	0	2,721	3,289	1,092						
Provisions & other liab	2,544	5,384	6,107	6,590	6,856						
Total liabilities	9,003	13,131	13,966	15,689	12,915						
Shareholders' equity	14,338	15,833	20,318	21,400	21,689						
Minority interests	4,038	4,759	5,678	6,315	6,883						
Total equity	18,376	20,592	25,996	27,715	28,572						
Net debt	-1,670	-1,551	-907	-1,360	-1,705						
Net debt to equity (%)	-9.1	-7.5	-3.5	-4.9	-6.0						

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Costs escalating rapidly

We cut Kumba's earnings forecasts up to 4% over the next five years to reflect higher cash cost assumptions.

Figure 1. Kumba's earnings revision summary

Kumba Iron Ore diluted HEPS (ZAR)	2012F	2013F	2014F	2015F	2016F
CIRA New	58.32	59.25	52.80	50.26	49.47
CIRA Previous	60.08	61.61	53.56	51.71	49.93
% change	-3	-4	-1	-3	-1
I-Net consensus - 9 February 2012	58.49	61.61			

Source: Citi Investment Research and Analysis, I-Net

Kumba has to increase waste mining by 30Mtpa over the next three years. Management guided that product costs per tonne could increase by 10%p.a., excluding inflation as a result. Our mining inflation forecasts of 11% and lower after 2011 could therefore still be too light.

Figure 2. Analysis of Kumba's unit costs in rand terms

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Total tonnes mined (Mt)	148	207	246	267	317	304	280	270
% change year on year	22%	40%	19%	9%	19%	-4%	-8%	-4%
Mining and beneficiation costs per tonne mined (rand)	28	24	28	31	33	37	42	44
% change year on year	-6%	-14%	17%	11%	4%	14%	12%	5%
Stripping ratio - Sishen	1.77	2.00	2.63	2.80	3.20	3.70	3.60	3.50
Cash costs/tonne (rand)								
Mining and beneficiation costs	102	116	160	176	195	215	222	227
% change year on year	-7%	14%	38%	10%	11%	10%	3%	2%
Selling, rail and port costs	83	84	100	116	127	136	138	139
Mining royalties	0	40	47	53	48	46	44	45
Total FOB cash costs per tonne	185	240	307	344	370	396	404	411
% change year on year	-3%	30%	28%	12%	7%	7%	2%	2%

Source: Company Reports and CIRA Estimates

We forecast only a 2% decline in 2012 unit cash costs in US\$ terms, mostly due to our 15% weaker rand forecast. Our forecasts beyond 2012 are below 4%p.a., which likely poses upside risk given increasing mining complexity. We believe export EBITDA margins may have peaked at 73% in 2011. Note that cash costs almost doubled since 2009, partly due to the introduction of royalties in 2010.

Figure 3. Analysis of Kumba's unit costs and margins in US\$ terms

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Mining and beneficiation costs	12	16	22	21	22	24	24	24
Selling, rail and port costs	10	12	14	14	15	15	15	15
Mining royalties	0	5	7	6	5	5	5	5
Total FOB cash costs per tonne (USD)	22	33	42	41	42	44	44	43
% change	-3%	49%	28%	-2%	3%	3%	0%	0%
EBITDA margin on export iron ore	66%	74%	73%	70%	65%	61%	59%	60%

Source: Company Reports and CIRA Estimates

Expensive relative to peers

On our numbers, Kumba is 20% more expensive on a PE multiple basis and 53% more expensive on an EV/EBITDA basis than other iron ore producers.

We believe the key underpin to Kumba's share price is its attractive estimated dividend yield of around 10%.

Figure 4. Global iron ore producer peer comparison*

	Rating & risk	Price (US\$)	2012E PE multiple	2012E EV/ EBITDA
Kumba's peers				
BHP Billiton	Buy	33.2	8.8	6.4
Rio Tinto	Buy	60.1	7.5	3.4
Vale	Buy	26.4	7.9	5.0
Mt Gibson Iron	Neutral H	1.5	4.6	1.8
Atlas Iron	Buy	3.6	12.3	6.6
Fortescue Metals	Buy	5.8	9.8	7.2
Sesa Goa	Sell	4.7	4.6	2.3
Cliffs Natural	Buy	76.6	7.7	5.2
Grange Resources	Buy H	0.7	7.8	2.4
Average for peers			7.9	4.5
Kumba - Attributable (74%)	Sell	73.1	9.5	6.8
<i>Kumba premium over peers</i>			<i>20%</i>	<i>53%</i>

Source: dataCentral, CIRA *Priced at 9 February 2012

Kumba's results undershot Citi's forecasts

Kumba reported 19% growth in FY11 headline earnings per share to R53.13, slightly below Citi's forecast of R55.57 but in line with 16 January trading statement guidance of R51.40–R55.80. Earnings growth was driven by:

- 26% increase in export iron ore prices and
- a 3% increase in export sales volumes.
- An R18 million rise in profit from shipping operations. Total tonnes shipped by Kumba on behalf of customers increased by 3.0Mt from 18.7Mt in 2010 to 21.7Mt for 2011

The positive impact of the above was offset by:

- a 6% drop in Sishen's production due to high rainfall
- A 36% increase (R2.5 billion) in operating expenses (excluding selling and distribution expenses, shipping expenses and the mineral royalty) driven by the 17% increase in waste mined at Sishen and 33% increase in waste mined at Thabazimbi, higher maintenance activity, inflationary pressures and a significant rise in the cost of diesel;

Final dividend per share of R22.50 brings total FY11 dividends to R44.20 (full year payout ratio: 83%), slightly ahead of Citi's forecast of R43.70 (I-Net's consensus: R41.87). However, we believe Kumba's share price could fall by the dividend amount when it trades ex-div.

Despite 5% lower production of 41.3Mt, sales were up by 1% to 43.5Mt, due to inventory sales of around 2.20Mt. Export volumes increased 3% to 37.1Mt, in line with our forecast.

Kumba reported a fatality-free year and a commendable 33% improvement in LTIFR. Kumba ranked 2nd in our recent efficiency and productivity analysis “Sweating for Success”, just behind Rio Tinto, with strong all round performance. We believe safety is the foundation for efficiency and productivity.

Figure 5. Kumba’s 2011 results vs. Citi’s forecasts and last year’s

	FY 2011 reported	FY 2011 (Citi forecast)	% diff	FY 2010	% change
Per share information (rand)					
Headline earnings per share (HEPS)	53.13	55.57	-4	44.67	+19
Final dividend per share (DPS)	22.50	22.00	+2	21.00	+7
Total DPS for the year	44.20	43.70	+1	34.50	+28
Payout ratio	83%	79%		77%	
Income statement forecasts (Rm)					
Revenue	48,553	48,246	+1	38,704	+25
EBIT	31,996	33,565	-5	25,138	+27
EBIT margin (%)	66	70		65	
Headline earnings	17,048	17,865	-5	14,328	+19
Balance sheet and cash flow (Rm)					
Net debt (cash)	(1,551)	(2,776)	+44	(1,670)	+7
Capital expenditure (Rm)	5,849	5,588	+5	4,723	+24
Operating statistics (Mt)					
Production	41.3	41.9	-1	43.4	-5
Sales	43.5	43.6	-0	43.1	+1
- Export	37.1	37.1	-0	36.1	+3
- Domestic	6.4	6.4	-1	7.0	-9

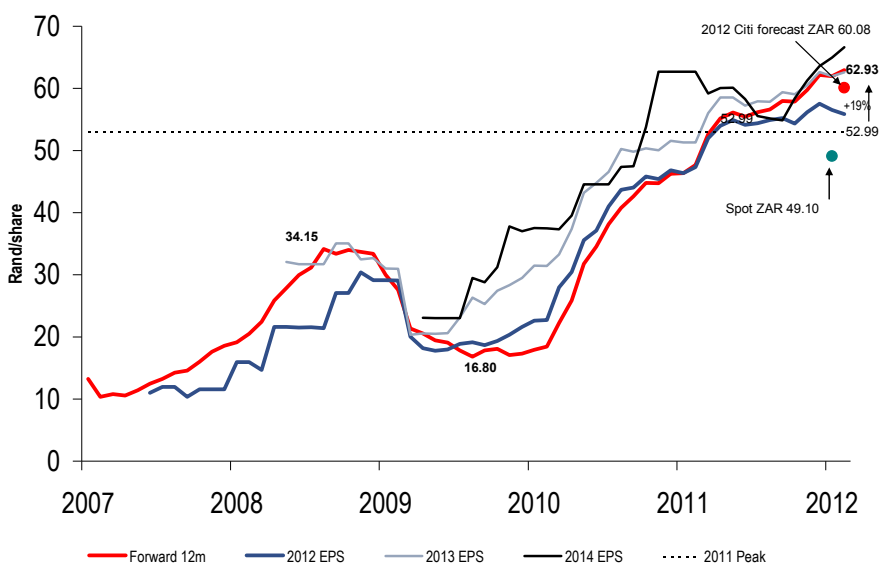
Source: Company Reports and CIRA Estimates

Earnings momentum slowing

It seems that consensus earnings upgrade momentum for Kumba is slowing down.

Datastream's 12-Month forward consensus earnings for Kumba is R62.93, which is 19% above last year's record earnings. Stabilising/declining iron ore prices, rapidly rising costs and a stubbornly strong rand pose downside risk to earnings forecasts, which could weigh on Kumba's share price performance. We calculate Kumba's FY12 earnings using spot rand and iron ore prices at R49.10, which implies 22% to consensus earnings.

Figure 6. Kumba's consensus earnings per share over time (rand)



Source: DataStream; CIRA

Commodity price and exchange rate forecasts

The forecasts below represent Citi's house forecasts.

Figure 7. Commodity price and exchange rate forecasts (average per calendar year)

Average per calendar year	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	LT (Real)
Precious commodities													
Silver (US\$/oz)	14.80	20.72	36.02	29.75	27.13	24.13	21.13	18.13	17.00	17.26	17.67	18.10	15.00
Platinum (US\$/oz)	1,203	1,612	1,720	1,609	1,675	1,725	1,700	1,738	1,781	1,826	1,871	1,918	1,550
Palladium (US\$/oz)	263	526	733	775	925	900	850	695	712	730	748	767	620
Rhodium (US\$/oz)	1,594	2,455	2,014	1,650	1,850	2,500	3,000	3,475	3,562	3,651	3,742	3,836	3,100
3PGM basket (US\$/oz) (63%Pt,30%Pd,7%Rh)	948	1,345	1,444	1,362	1,462	1,532	1,536	1,546	1,585	1,625	1,665	1,707	1,380
Base metals													
Aluminium (US\$/tonne)	1,664	2,173	2,398	2,275	2,525	2,600	2,550	2,522	2,585	2,650	2,716	2,784	2,250
Aluminium (US cents/lb)	75	99	109	103	115	118	116	114	117	120	123	126	102
Copper (US\$/tonne)	5,148	7,536	8,811	7,825	8,527	8,200	8,000	6,950	7,124	7,302	7,485	7,672	6,200
Copper (US cents/lb)	234	342	400	355	387	372	363	315	323	331	339	348	281
Nickel (US\$/tonne)	14,653	21,833	22,842	19,500	22,819	24,650	24,000	22,420	22,980	23,555	24,144	24,747	20,000
Nickel (US cents/lb)	665	990	1,036	885	1,035	1,118	1,089	1,017	1,042	1,068	1,095	1,123	907
Zinc (US\$/tonne)	1,654	2,160	2,190	2,050	2,295	2,525	2,400	2,354	2,413	2,473	2,535	2,598	2,100
Zinc (US cents/lb)	75	98	99	93	104	115	109	107	109	112	115	118	95
Lead (US\$/tonne)	1,720	2,148	2,397	2,150	2,400	2,600	2,500	2,466	2,528	2,591	2,656	2,722	2,200
Lead (US cents/lb)	78	97	109	98	109	118	113	112	115	118	120	123	100
Uranium (US\$/lb)	47	46	56	50	50	50	50	56	57	59	60	62	50
Steelmaking materials													
Iron ore spot (CIF China) (US\$/t)	85	152	175	149	135	125	120	115	110	108	105	105	81
Iron ore fines (FOB) (US\$/dmu)	109	177	262	219	194	175	167	156	148	144	140	140	111
Iron ore fines (FOB) (USD/tonne)	69	112	166	139	123	111	106	99	94	91	89	89	71
Iron ore lump (FOB) (US\$/dmu)	134	196	288	241	213	192	183	171	162	158	154	154	120
Iron ore lump (FOB) (USD/tonne)	85	125	183	153	135	122	116	109	103	100	98	98	76
Hard coking coal (US\$/tonne)	172	191	289	256	248	240	230	215	222	226	231	235	200
Semi soft benchmark (US\$/tonne)	116	139	210	173	168	168	159	146	151	154	157	160	150
Manganese ore - CIF (US\$/mtu)	5.43	7.71	6.07	6.00	6.00	6.00	6.00	5.83	5.96	6.08	6.20	6.32	5.20
Ferro manganese - CIF (US\$/tonne)	1,267	1,449	1,385	1,200	1,300	1,300	1,300	1,457	1,489	1,519	1,550	1,581	1,300
Ferrochrome (US\$/lb)	0.93	1.24	1.26	1.25	1.00	1.00	1.00	1.12	1.15	1.17	1.19	1.22	1.00
Energy													
Richards Bay thermal coal (US\$/tonne)	65	92	117	120	139	153	149	144	145	148	151	154	109
Heavy minerals													
Rutile (US\$/tonne)	535	538	839	2,525	2,600	2,600	2,600	617	630	643	656	669	550
Zircon (US\$/tonne)	947	942	1,880	2,500	2,600	2,600	2,600	953	974	993	1,013	1,034	850
Synrutilite (US\$/t)	438	441	687	2,050	2,100	2,100	2,100	561	536	546	557	569	500
Titanium Slag (US\$/tonne)	307	333	574	1,502	1,538	1,538	1,538	359	367	374	382	389	320
TiO2 Pigment (US\$/tonne)	2,605	2,100	1,918	1,966	2,015	2,065	2,117	2,130	2,177	2,221	2,265	2,311	2,400
Ilmenite (US\$/tonne)	87	75	129	250	250	250	250	135	137	140	143	146	120
Currency exchange rates													
US\$/ZAR	8.40	7.30	7.25	8.35	8.72	9.08	9.47	10.00	10.22	10.58	10.96	11.35	10.00
US\$/AUD	0.79	0.92	1.03	1.03	0.96	0.92	0.89	0.90	0.89	0.87	0.85	0.84	0.90
US\$/EUR	1.39	1.33	1.39	1.38	1.37	1.37	1.36	1.30	1.30	1.29	1.29	1.28	1.30
US\$/CHP	559	502	482	524	547	570	594	613	646	680	716	754	613
US\$/BRL	2.00	1.76	1.67	1.86	1.94	2.02	2.10	2.17	2.29	2.41	2.54	2.67	2.17
US\$/COP	2,156	1,898	1,848	1,982	2,070	2,155	2,246	2,320	2,443	2,573	2,709	2,853	2,320
Inflation													
US CPI index	215	218	225	230	234	239	244	249	254	259	264	269	
US Inflation	0%	2%	3%	2%	2%	2%	2%	2%	2%	2%	2%	2%	

Source: I-Net; Bloomberg; Company reports; CIRA

Key recent publications

Figure 8. Key publications on diversified miners over the past year

Date	Publication	No. of Pages
13-Jan-11	Metals and Mining - The Easy Money Has Been Made*	72
08-Feb-11	Metals & Mining - Supercycle well advanced - Neutral on SA miners	34
14-Feb-11	Metals and Mining - Commodity price upgrades, but near-term peak margins pose risk	40
15-Feb-11	Anglo American (AGLJ.J) - Cyclically-Adjusted PE and Price to Book Suggest Valuation Full	10
4-Apr-11	Metals & Mining - Optimistic long-term iron ore price outlook increases valuations	42
6-Apr-11	Metals & Mining - Strike while the iron is (still) hot?	96
15-May-11	Metals & Mining; Metals & Mining; Metals & Mining - Souring Sentiment Offers Opportunities – Buy Anglo, BHP, ARM	60
20-May-11	Anglo American (AGLJ.J) - Silicosis Liabilities – a Risk to our Positive Investment Stance	10
28-Jun-11	Metals & Mining - Nationalisation – Killing The Goose That Lays The Golden Eggs	19
14-Jul-11	Metals & Mining - Coal and mineral sands boost, but costs spoil the party	26
29-Jul-11	Metals & Mining - The Unions Strike Again	14
1-Aug-11	Anglo American (AGLJ.J) - Cash Flow Kickers Coming	22
10-Aug-11	Metals & Mining - Opportunities in Uncertain Times	16
4-Sep-11	Metals & Mining - Uncertainty and Fear Create Value	52
20-Sep-11	Metals & Mining - Panic Provides	84
1-Nov-11	Metals & Mining - Efficiency Rewards: BHP Performed Best; Anglo Our Top Pick	76
5-Dec-11	Metals & Mining - Offering Value – Anglo is Our Top Pick	64
09-Jan-12	Metals & Mining - Less room for disappointment in 2012	76
16-Jan-12	Metals & Mining - Sweating for Success	120

Source: Citi Investment Research and Analysis

Peer comparison

Figure 9. Mining company peer comparison (calendarised)*

	RIC Code	Citi's Rating	Price (US\$)	Historic P/E		Forward P/E		EV/ EBITDA		FCF yield		Div Yld		P/B		ROE	
				2009	2010	2011	2012E	2011E	2012E	2011E	2012E	2011E	2012E	2011E	2012E	2011E	2012E
FTSE ALL SHARE (GBP)	.FTAS			20	26	14.1	11.2	7.3	7.9	5%	5%	4%	4%	2.9	2.6	27%	23%
FTSE/JSE ALL SHARE (ZAR)	.JALSH			18	16	12.7	11.8	8.2	7.6	7%	6%	3%	4%	3.7	3.3	31%	29%
Major diversified miners																	
BHP Billiton	BLT.L	Buy	33.4	16	11	8.7	8.8	6.5	6.4	8%	5%	3%	4%	2.9	2.4	37%	29%
Rio Tinto	RIO.L	Buy	59.9	17	8	7.3	7.9	3.5	3.3	9%	8%	2%	2%	1.6	1.3	24%	18%
Anglo American	AAL.L	Buy	45.0	21	11	9.9	9.3	5.2	4.5	15%	8%	2%	2%	1.3	1.1	25%	13%
Vale	VALE.N	Buy	26.4	26	8	6.4	7.9	4.4	5.0	6%	2%	1%	1%	1.7	1.4	29%	20%
Average				20	10	8.1	8.5	4.9	4.8	9%	6%	2%	2%	1.9	1.6	29%	20%
South African mid-cap miners																	
Kumba - Attributable (74%)	KIOJ.J	Sell	72.2	25	12	9.8	9.1	7.0	6.5	9%	10%	8%	9%	9.6	7.3	109%	92%
Exxaro - proportionately consolidated	EXXJ.J	Buy	27.1	29	14	9.2	6.1	4.7	3.4	4%	9%	3%	6%	3.1	2.2	40%	44%
ARM	ARIJ.J	Buy	25.5	21	16	11.6	9.8	5.2	4.4	3%	6%	3%	3%	1.8	1.6	17%	18%
Assore	ASRJ.J	Buy	32.8	12	13	8.3	7.8	5.7	5.3	6%	10%	3%	4%	2.4	2.0	32%	27%
Average				22	14	9.7	8.2	5.7	4.9	6%	9%	4%	6%	4.2	3.3	50%	45%
Copper																	
Freeport McMoran	FCX.N	Neutral	46.5	16	10	9.5	13.1	4.8	5.9	9%	1%	3%	4%	2.8	2.5	32%	21%
Southern Copper Corp	SCCO.N	Neutral	35.0	32	19	13.1	17.8	8.0	9.5	6%	3%	6%	3%	7.2	6.0	56%	37%
Antofagasta	ANTO.L	Sell	20.8	31	21	16.3	14.1	5.7	5.4	9%	9%	5%	5%	3.3	3.1	20%	22%
Kazakhmys	KAZ.L	Buy	18.3	16	7	5.7	6.3	2.4	2.2	6%	0%	2%	3%	1.0	0.9	14%	16%
Jiangxi Copper	0358.HK	Buy	2.8	23	11	10.1	8.9	7.2	6.0	11%	12%	1%	2%	1.6	1.4	17%	16%
FST Quantum Minerals	FQM.L	Neutral	21.7	17	12	17.0	27.0	7.7	9.3	-6%	-11%	3%	1%	2.6	2.2	17%	9%
Grupo Mexico	GMEXICOB.MX	Neutral	3.3	29	16	11.1	15.3	5.7	6.8	7%	6%	5%	3%	3.8	3.2	36%	23%
Average				23	14	11.8	14.6	5.9	6.4	6%	3%	4%	3%	3.2	2.7	28%	20%
Ferrous																	
Siderurgica Naci	CSNA3.SA	Neutral	10.7	11	11	5.6	13.8	5.6	6.1	5%	-3%	4%	2%	3.7	3.2	65%	25%
Mt Gibson Iron	MGX.AX	Neutral	1.5	18	9	5.8	4.6	2.9	1.8	13%	22%	4%	6%	1.2	1.0	23%	24%
Atlas Iron	AGO.AX	Buy	3.6	-	29	15.1	12.3	10.5	6.6	6%	3%	1%	2%	1.6	1.6	12%	13%
ENRC	ENRC.L	Buy	11.0	14	7	6.7	6.9	3.9	4.1	3%	-5%	3%	3%	1.2	1.1	20%	17%
Fortescue Metals	FMG.AX	Buy	5.8	39	15	10.5	9.8	7.0	7.2	-7%	-14%	1%	2%	5.8	3.9	56%	48%
Cliffs Natural	CLF.N	Buy	76.6	-	11	7.1	7.7	4.8	5.2	10%	7%	1%	1%	1.9	1.5	33%	22%
Average				23	12	7.8	8.3	5.2	4.7	6%	3%	2%	2%	2.4	1.9	35%	26%
Coal																	
New Hope	NHC.AX	Neutral	6.4	21	29	26.9	20.8	24.4	16.5	2%	-4%	4%	3%	2.1	2.0	17%	10%
Whitehaven Coal	WHC.AX	Buy	6.0	37	43	31.5	14.8	15.7	8.4	-2%	6%	2%	3%	2.5	2.2	5%	16%
Adaro Energy	ADRO.JK	Buy	0.2	17	27	14.9	8.7	5.4	5.3	7%	11%	1%	2%	2.9	2.3	21%	29%
China Coal	1898.HK	Buy	1.3	15	15	11.2	9.0	6.1	5.4	-18%	-2%	2%	3%	1.4	1.2	13%	14%
China Shenhua	1088.HK	Buy	4.5	18	15	13.0	11.4	7.0	6.1	5%	7%	3%	3%	2.5	2.1	20%	20%
Arch Coal	ACI.N	Buy	15.2	41	15	12.4	7.1	6.5	5.2	8%	12%	3%	3%	0.9	0.8	6%	12%
Peabody Energy	BTU.N	Buy	36.8	19	12	9.7	11.5	6.2	5.7	2%	4%	1%	1%	1.8	1.6	19%	15%
Average				22	21	16.3	13.2	9.8	7.2	1%	6%	2%	2%	1.8	1.6	13%	15%
Nickel & Zinc																	
Sterlite Industries	STRL.BO	Buy	2.6	11	9	7.4	6.9	3.5	3.1	3%	7%	1%	1%	1.0	0.8	14%	13%
Norilsk	GMKN.RTS	Neutral	175.2	13	6	6.3	7.2	4.0	4.2	11%	8%	4%	3%	1.6	1.3	27%	20%
Average				14	9	8.8	9.1	4.9	4.6	6%	7%	2%	2%	1.6	1.4	20%	17%
Iluka Resources	ILU.AX	Buy	19.5	-88	210	14.5	5.4	8.0	3.2	8%	21%	4%	9%	6.0	3.8	44%	85%
Average excl. precious				5	41	11.0	9.6	6.3	5.1	6%	8%	3%	4%	3.0	2.3	31%	33%
PGM																	
Aquarius Platinum	AQP.L	Neutral	2.5	122	15	20.6	19.1	8.3	8.8	-1%	3%	0%	0%	1.5	1.4	0%	8%
Anglo American Platinum	AMSJ.J	Sell	73.6	186	29	25.2	21.3	12.1	9.7	2%	2%	2%	2%	2.6	2.4	10%	12%
Impala Platinum	IMPJ.J	Buy	22.2	19	18	14.7	12.7	7.5	6.6	3%	4%	3%	4%	2.2	2.0	14%	16%
Northam Platinum	NHMJ.J	Buy	4.4	19	25	28.0	16.4	16.9	10.3	-10%	-10%	1%	1%	1.2	1.1	4%	7%
Lonmin	LMIL	Neutral	16.6	-65	21	15.5	15.6	6.0	5.5	-3%	6%	2%	2%	1.1	1.1	8%	7%
Average				56	22	20.8	17.0	10.2	8.2	-2%	1%	2%	2%	1.7	1.6	7%	10%
Gold/Precious																	
AngloGold Ashanti	ANGJ.J	Neutral	45.9	-325	-10	12.8	11.1	6.4	5.4	7%	7%	1%	1%	3.4	2.7	35%	27%
Gold fields	GFIJ.J	Sell	16.8	35	22	11.7	9.7	4.8	4.3	10%	11%	3%	3%	2.0	1.7	16%	19%
Harmony Gold Mng	HARJ.J	Sell	12.7	60	78	22.9	16.8	10.1	6.8	2%	6%	0%	1%	1.3	1.2	5%	8%
Barrick Gold	ABX.N	Buy	49.1	25	15	10.1	9.4	6.3	5.9	-1%	6%	1%	1%	1.6	1.4	19%	16%
Newmont Mining	NEM.N	Buy	60.7	23	13	12.9	12.3	5.8	5.9	6%	3%	2%	2%	2.0	1.9	16%	16%
Newcrest Mining	NCM.AX	Buy	36.1	23	21	21.5	16.2	11.7	8.8	-1%	2%	1%	2%	1.8	1.7	9%	11%
Average				-27	23	15.3	12.6	7.5	6.2	4%	6%	1%	2%	2.0	1.8	17%	16%
Average - all miners				12	29	15.7	13.1	8.0	6.5	3%	5%	2%	2%	2.2	1.9	18%	19%

Source: Powered by dataCentral * Priced on 9 February 2012. dataCentral is CIRA's proprietary database, which includes Citi estimates, data from company reports and feeds from Reuters, Datastream, First Call, IBES and Toyo Keizai.

Financial statements and ratio analysis

We forecast 10% growth in Kumba's FY12 diluted HEPS to R58.32 and further 2% growth to R59.25 in FY13.

Figure 10. Kumba Iron Ore financial statements and ratio analysis

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Income Statement (ZARm)								
Revenue	23,408	38,704	48,553	54,455	57,405	55,241	54,850	57,363
Cash operating costs	(10,033)	(12,801)	(15,580)	(18,517)	(21,882)	(23,173)	(23,887)	(25,791)
Underlying EBITDA	13,375	25,903	32,973	35,938	35,523	32,068	30,963	31,572
Depreciation	(530)	(765)	(997)	(1,343)	(1,557)	(1,928)	(2,208)	(2,694)
Impairments	0	0	0	0	0	0	0	0
Underlying EBIT	12,845	25,138	31,976	34,595	33,966	30,140	28,755	28,878
Exceptional items	35	(7)	(10)	0	0	0	0	0
Net interest	(127)	(29)	92	(31)	21	146	71	(118)
Profit before tax	12,753	25,102	32,058	34,564	33,987	30,286	28,826	28,760
Taxation	(3,949)	(6,813)	(9,760)	(9,620)	(8,497)	(7,571)	(7,207)	(7,190)
Profit after tax	8,804	18,289	22,298	24,944	25,490	22,714	21,620	21,570
Minority interest	(1,812)	(3,966)	(5,256)	(6,127)	(6,373)	(5,679)	(5,405)	(5,608)
Net profit for the year	6,992	14,323	17,042	18,817	19,118	17,036	16,215	15,962
Adjustments	(20)	5	6	0	0	0	0	0
Headline earnings	6,972	14,328	17,048	18,817	19,118	17,036	16,215	15,962
Number of shares (millions)								
Weighted average	319	321	321	322	322	322	322	322
Diluted weighted average	320	322	322	323	323	323	323	323
Closing	320	322	322	322	322	322	322	322
EPS (ZAR)	21.94	44.66	53.11	58.43	59.36	52.90	50.35	49.56
Headline EPS (ZAR)	21.87	44.67	53.13	58.43	59.36	52.90	50.35	49.56
Diluted HEPS (ZAR)	21.76	44.54	52.99	58.32	59.25	52.80	50.26	49.47
Growth (%)	-4	+105	+19	+10	+2	-11	-5	-2
PE multiple at R519/share	23.9	11.7	9.8	8.9	8.8	9.8	10.3	10.5
DPS declared (ZAR)	14.60	34.50	44.20	50.00	54.00	49.00	46.00	46.00
Dividend yield at R519/share (%)	2.8	6.6	8.5	9.6	10.4	9.4	8.9	8.9
Dividend payout ratio (%)	67	77	83	86	91	93	91	93
Key Income Statement ratios								
Revenue growth (% y-o-y)	10	65	25	12	5	-4	-1	5
Underlying EBITDA margin (%)	57	67	68	66	62	58	56	55
Underlying EBIT margin (%)	55	65	66	64	59	55	52	50
Interest cover (times)	101	867	-	-	-	-	-	244
Tax rate (%)	31	27	30	28	25	25	25	25

Source: Company reports, I-Net, CIRA estimates

Figure 11. Kumba Iron Ore's balance sheet

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Balance Sheet (ZARm)								
Non-current operating assets	11,595	15,901	20,917	24,584	26,527	27,598	29,987	35,950
Working capital	2,593	2,924	2,845	5,949	5,755	5,461	5,586	5,897
Net tax payable	109	(61)	(188)	0	0	0	0	0
Net operating assets	14,297	18,764	23,574	30,533	32,282	33,060	35,572	41,847
Investments	307	425	663	663	663	663	663	663
Cash	891	4,855	4,742	4,989	6,293	3,343	4,171	7,135
Total invested capital	15,495	24,044	28,979	36,185	39,238	37,066	40,406	49,645
Equity	9,931	16,821	21,029	26,425	27,990	28,544	30,538	33,166
Minority interest	1,650	4,038	4,759	5,678	6,315	6,883	7,424	7,984
Debt	3,914	3,185	3,191	4,082	4,933	1,639	2,445	8,495
Total invested capital	15,495	24,044	28,979	36,185	39,238	37,066	40,406	49,645
Key Balance Sheet ratios								
Non-current asset turnover (times)	2.0	2.4	2.3	2.2	2.2	2.0	1.8	1.6
Net debt (ZARm)	3,023	(1,670)	(1,551)	(907)	(1,360)	(1,705)	(1,726)	1,360
Gearing (Net debt:(Net debt + equity)) (%)	23.3	(11.0)	(8.0)	(3.6)	(5.1)	(6.4)	(6.0)	3.9
Working capital turnover (days)	40	28	21	40	37	36	37	38
NAV per share (rand)	31	52	65	82	87	89	95	103
Price to book at R519/share	16.7	9.9	7.9	6.3	6.0	5.9	5.5	5.0
Normalised price to book at R519/share assuming equity @\$120/t		4.0	4.0	3.7	3.3	3.3	3.3	3.2
ROCE (%)	101.7	152.1	151.1	127.9	108.1	92.3	83.8	74.6
Return on net operating assets (%)	80.2	116.5	127.6	98.6	82.6	70.0	64.6	59.8
Return on equity (%)	71.8	107.1	90.1	79.3	70.3	60.3	54.9	50.1
Return on equity at replacement cost of US\$120/t	18.0	34.4	40.5	41.4	37.5	33.7	32.4	30.3

Source: Company reports, I-Net, CIRA estimates

Kumba's average ROE since 2007 was 95%, which also boosted its price to book. We believe there are two main reasons for this.

1. Accounting anomaly

- Kumba was spun out of Kumba Resources (now Exxaro) with a very low equity value of R1.5bn in 2006 (R4.5bn in 2007).
- Operating assets were largely depreciated and debt-funded. Gearing in 2006: 66.5%, and 2007: 36.1%.
- Since 2007, Kumba's average dividend payout ratio has been 79%, so book (equity) never built up in the company.

2. Attractive industry and well positioned

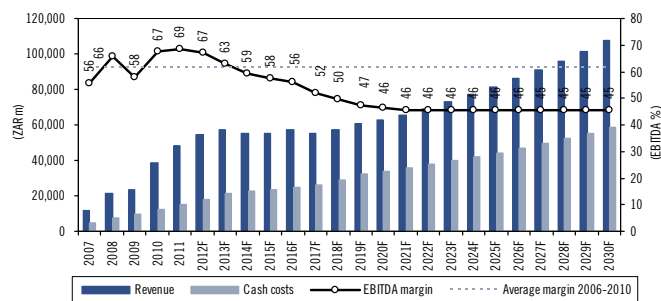
- We restate Kumba's equity value using US\$120 per annual production tonne. Replacement cost could be as high as US\$180/t, on our estimates.
- On that basis Kumba's ROE averaged 25% since 2007.
- Our near-term forecasts indicate ROEs of 40%+ and normalising to low 20%s. These attractive ROEs are indicative of the attractiveness of the iron ore industry in general, as well as Kumba's competitiveness within the industry. Kumba's desirable product (60% lump and 65% Fe content) is margin-enhancing.

Figure 12. Kumba Iron Ore's free cash flow statement

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F
Cash Flow Statement (ZARm)								
Underlying EBITDA	13,375	25,903	32,973	35,938	35,523	32,068	30,963	31,572
Movements in provisions	(222)	211	229	160	85	47	104	260
Cash tax on EBIT	(2,501)	(6,098)	(5,197)	(8,087)	(8,093)	(7,311)	(6,697)	(6,002)
Movements in working capital	(107)	(331)	79	(3,104)	193	294	(124)	(311)
Operating cash flow	10,545	19,685	28,084	24,908	27,708	25,098	24,245	25,519
Growth capex	(2,983)	(3,447)	(3,268)	(2,010)	(500)	0	(1,500)	(5,500)
Maintenance capex	(1,217)	(1,624)	(2,745)	(3,000)	(3,000)	(3,000)	(3,096)	(3,157)
Acquisitions and disposals	0	0	0	0	0	0	0	0
Free cash flow	6,345	14,614	22,071	19,898	24,208	22,098	19,649	16,862
Non-operating cash flow (net of tax)	203	(18)	(74)	125	230	318	254	266
Cash available to providers of capital	6,548	14,596	21,996	20,023	24,439	22,416	19,903	17,127
Interest paid (net of tax)	(297)	(128)	(107)	(147)	(216)	(213)	(203)	(351)
Net payments to minority shareholders	(1,809)	(1,578)	(4,535)	(5,208)	(5,735)	(5,111)	(4,864)	(5,047)
Equity shareholders' cash	4,442	12,890	17,354	14,668	18,488	17,092	14,836	11,729
Dividends and share buy backs	(7,417)	(8,197)	(17,473)	(15,312)	(18,035)	(16,747)	(14,815)	(14,815)
Advances (repayments) of debt	56	(729)	6	891	851	(3,294)	806	6,050
Increase (decrease) in cash	(2,919)	3,964	(113)	247	1,303	(2,949)	828	2,964
Key Cash Flow ratios								
EV/EBITDA at R519/share (minorities at market value)	16.7	8.6	6.8	6.2	6.3	7.0	7.2	7.1
Free cash flow per share	20	46	69	62	75	69	61	52
Capex/EBITDA (%)	22.3	13.3	9.9	5.6	1.4	0.0	4.8	17.4
Cash tax on EBIT/EBIT (%)	19.5	24.3	16.3	23.4	23.8	24.3	23.3	20.8
Free cash flow growth rate (%)	-14	+130	+51	-10	+22	-9	-11	-14
Equity shareholders' cash/market capitalisation (%)	2.7	7.7	10.4	8.8	11.1	10.2	8.9	7.0

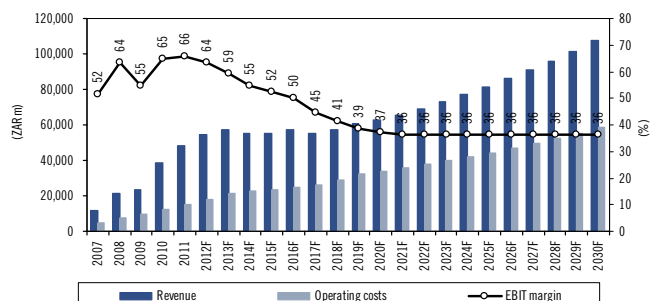
Source: Company reports, I-Net, CIRA estimates

Figure 13. Revenue, cash costs and EBITDA margin



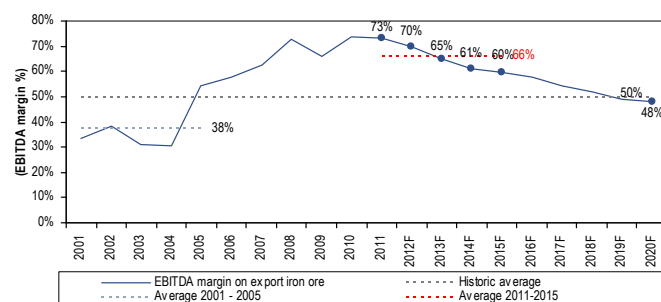
Source: Company reports, CIRA estimates

Figure 14. Revenue, operating costs and EBIT margin



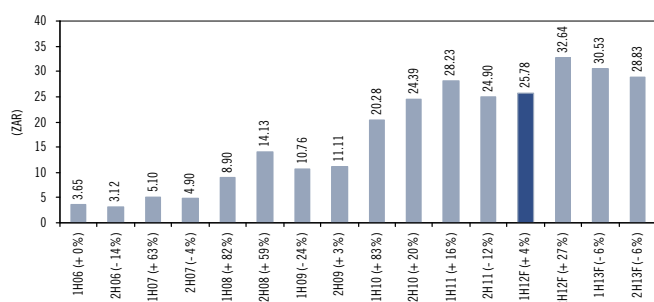
Source: Company reports, CIRA estimates

Figure 15. Kumba's EBITDA margin on export iron ore



Source: Company reports, CIRA estimates

Figure 16. Kumba's half-yearly HEPS profile



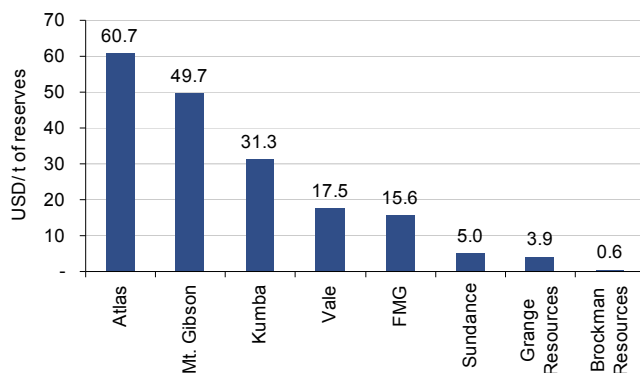
Source: Company reports, CIRA estimates

Figure 17. Iron ore miners enterprise value per tonne of reserves, resources and annual production

Company	Fe contained Reserves (mt)	Resources (mt)	Annual production mt	EV USD mn	EV/reserves USD /t	EV/resources USD /t	EV/annual production USD /t	Major Projects	Country
Vale	9,132	-	308	160,010	17.52	-	520	North, South & Southeast sys.	Brazil
Kumba	777	1,243	43	24,290	31.25	19.54	567	Sishen & Kolomela	South Africa
FMG	1,305	5,331	41	20,361	15.60	3.82	501	Chichester and Solomon	Australia
African Minerals	-	4,000	-	2,883	-	0.72	-	Tonkolili	Sierra Leone
Atlas	46	273	5	2,780	60.69	10.18	614	North Pilbara	Australia
Sundance	252	1,180	-	1,265	5.03	1.07	-	Mbalam	Cameroon
Zanaga	-	462	-	396	-	0.86	-	Zanaga	Congo
African Iron	-	51	-	278	-	5.42	-	Mayoko	Congo
Bellzone	-	299	-	92	-	0.31	-	Kalia and Forecariah	Guinea
Brockman Resources	451	651	-	270	0.60	0.41	-	Marillana	Australia
Grange Resources	157	327	2	619	3.93	1.89	310	Savage River & South Down	Australia
Cape Lambert	-	192	-	376	-	1.96	-	Marampa	Sierra Leone
Mt. Gibson	33	53	7	1,615	49.69	30.19	240	Tallering Peak & Ext. Hill	Australia

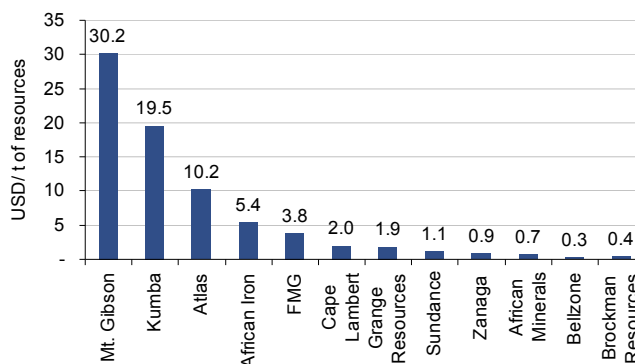
Source: Company reports, Bloomberg (latest reported data and current EV as on 09-2-2012).

Figure 18. Iron ore miners EV/ reserves tonne



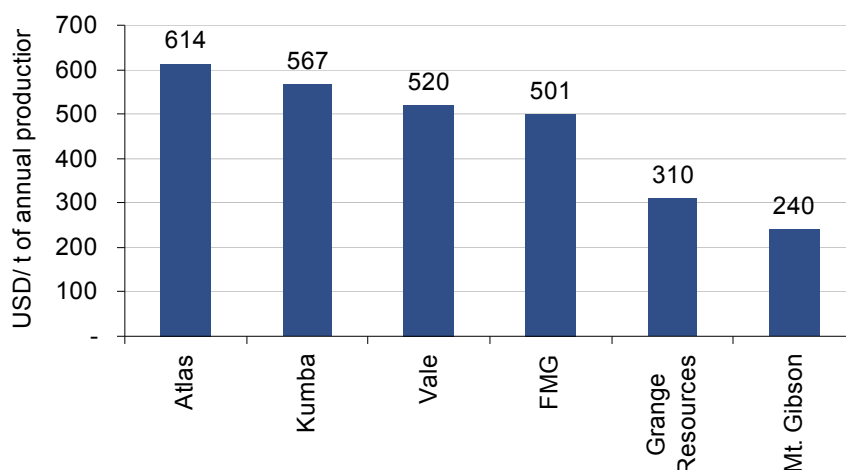
Source: Company reports, Bloomberg (current EV and reported reserves).

Figure 19. Iron ore miners EV/ resources tonne



Source: Company reports, Bloomberg (current EV and reported reserves).

Figure 20. Iron ore miners EV/ latest reported annual production tonne



Source: Company reports, Bloomberg

Analysis of cash costs per tonne

We forecast a slight decrease of 2% in Kumba's 2012E FOB unit cash costs to US\$41/tonne, after witnessing a 28% jump in FY'11. Note that its cash cost has almost doubled since 2009, due partly to the introduction of royalties in 2010.

Figure 21. Analysis of FOB cash costs per tonne

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F
Mining and beneficiation costs	12	16	22	21	22	24	24	24	24
Selling, rail and port costs	10	12	14	14	15	15	15	15	14
Mining royalties	0	5	7	6	5	5	5	5	5
Total FOB cash costs per tonne (USD)	22	33	42	41	42	44	44	43	43
% change	-3%	49%	28%	-2%	3%	3%	0%	0%	-1%
EBITDA margin on export iron ore	66%	74%	73%	70%	65%	61%	59%	60%	59%

Source: Company reports, CIRA estimates

Figure 22. Stripping ratio and cost analysis (rand/tonne)

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	2018F
Total tonnes mined (Mt)	148	207	246	267	317	304	280	270	274	281
% change year on year	22%	40%	19%	9%	19%	-4%	-8%	-4%	2%	2%
Mining and beneficiation costs per tonne mined (rand)	28	24	28	31	33	37	42	44	45	46
% change year on year	-6%	-14%	17%	11%	4%	14%	12%	5%	3%	3%
Stripping ratio - Sishen	1.77	2.00	2.63	2.80	3.20	3.70	3.60	3.50	3.50	3.50
Cash costs/tonne (rand)										
Mining and beneficiation costs	102	116	160	176	195	215	222	227	231	236
% change year on year	-7%	14%	38%	10%	11%	10%	3%	2%	2%	2%
Selling, rail and port costs	83	84	100	116	127	136	138	139	141	142
Mining royalties	0	40	47	53	48	46	44	45	45	44
Total FOB cash costs per tonne	185	240	307	344	370	396	404	411	417	422
% change year on year	-3%	30%	28%	12%	7%	7%	2%	2%	1%	1%

Source: Company reports, CIRA estimates

Production and sales volume forecasts

We forecast 10% sales volume growth for FY12 as Kolomela ramps up operation and forecast inventory sales of around 0.7Mt, in our view. Volumes could increase from 42.9Mt in FY11E to 55.6Mt by FY17E, a CAGR growth of 4.4%.

Figure 23. Total Sishen Iron Ore Company sales (000 tonnes)

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	CAGR '11-'17	Reserve s (mt)	Life
Sishen main pit	28,958	28,053	25,359	27,500	29,000	29,000	29,000	29,656	30,552		684.7	24
Sishen jig plant	10,430	13,284	13,540	13,000	13,000	13,000	13,000	13,294	13,696			
Thabazimbi	2,555	2,047	903	800	800	800	800	800	0		12.3	6
Kolomela	0	0	1,466	5,000	9,000	9,000	9,000	9,340	9,813		213.6	24
SEP II	0	0	0	0	0	0	0	0	0			
Sishen Pellets	0	0	0	0	0	0	0	1,500	1,534			
Sishen C-Grade	0	0	0	0	0	0	0	0	0			
Kolomela Beneficiation Project	0	0	0	0	0	0	0	0	0			
Stock movement	(800)	(200)	1,600	700	1,000	500	0	0	0			
Total	41,143	43,184	42,868	47,000	52,800	52,300	51,800	54,590	55,595	4.43%	1,300	25
Growth (% year-on-year)	+28	+5	-1	+10	+12	-1	-1	+5	+2			

Source: Company reports, CIRA estimates

Figure 24. Sishen Iron Ore Company sales split by domestic and export (000 tonnes)

FYE December	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F	2018F
Export iron ore	34,219	36,086	37,131	41,208	47,008	46,508	46,008	48,798	50,603	53,984
Growth	37%	5%	3%	11%	14%	-1%	-1%	6%	4%	7%
Domestic iron ore	5,856	7,021	6,441	5,792	5,792	5,792	5,792	5,792	4,992	4,992
Total	40,075	43,107	43,572	47,000	52,800	52,300	51,800	54,590	55,595	58,976
Growth	21%	8%	1%	8%	12%	-1%	-1%	5%	2%	6%

Source: Company reports, CIRA estimates

Kumba Iron Ore Ltd

Company description

Kumba Iron Ore is a focused producer of high-grade iron ore and the fourth-largest supplier of seaborne iron ore. It operates the Sishen and Thabazimbi iron ore mines in South Africa with current production of 45Mtpa. Its most attractive aspects are its near-term volume growth through Kolomela (+9Mtpa), strong cash generation and dividend yield.

Investment strategy

We rate Kumba Iron Ore Sell. Although we believe it offers an attractive dividend yield of 8%+ over the next three years, it seems priced in. Current margins look unsustainably high. Longer term, we are concerned about significant downside risk to earnings as iron ore prices fall to marginal cost of production. We see four issues which continue to weigh down Kumba's investment case: 1) short resource life relative to peers limits growth and optionality; 2) margin erosion due to increasing mining complexity; 3) limited visibility on volume growth beyond Kolomela; and 4) potential for poor capital allocation (African growth strategy).

Valuation

Our Kumba target price of R430 is calculated using a discounted cash flow valuation, which takes into account optimistic long-term export EBITDA margins of 52%, as well as Kumba's considerable volume growth. Our DCF assumes a 13.1% nominal weighted average cost of capital; long-term (2016-30) nominal revenue growth of 5% per annum; long-term capex/EBITDA ratio of 22%; long-term ROE of 30%; and a terminal growth rate (after 2031) of 8.4% in rand terms.

Risks

Key risks to projected earnings, cash flows and valuation relate to weaker-than-expected commodity prices/economic growth and US\$. Country risk is a consideration with all producing assets in South Africa. Operating risk in Kumba is principally from higher inflation concerns in South Africa. Kumba is also involved in a legal dispute with ArcelorMittal SA and ICT, which may negatively impact our earnings forecasts and target price.

Four major upside risks to our target price are: 1) China's demand for iron ore outpaces new low cost supply and long-term margins stay at elevated levels; 2) A collapse in the rand, which would boost Kumba's earnings forecasts and valuation; 3) Corporate action - Anglo American already holds around 65% of Kumba and we believe it will have to offer a premium to market prices if it wants to buy out minorities; and 4) Kumba's attractive dividend yield.

Appendix A-1

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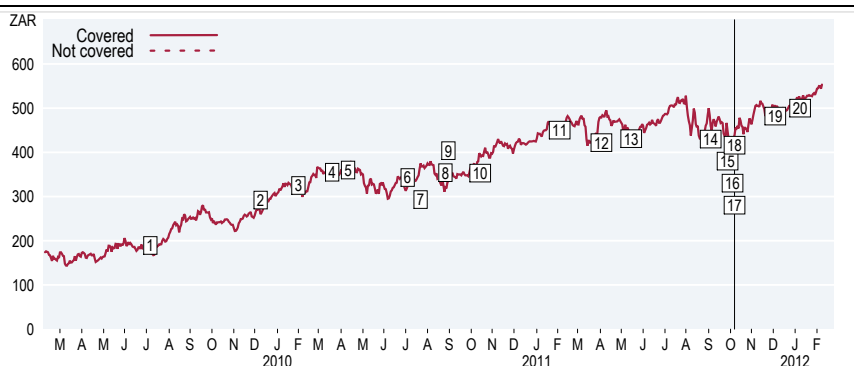
Kumba Iron Ore Ltd (KIOJ.J)

Ratings and Target Price History

Fundamental Research

Analyst: Johann Pretorius

Covered since December 9 2009



	Date	Rating	Target Price	Closing Price
1	7-Jul-09	*2M	*190.00	172.00
2	9-Dec-09	*3M	*250.00	260.00
3	1-Feb-10	3M	*300.00	322.50
4	19-Mar-10	3M	*330.00	344.50
5	12-Apr-10	3M	*360.00	366.50
6	4-Jul-10	*2M	*340.00	317.60
7	22-Jul-10	*3M	*360.00	375.00

* Indicates change

	Date	Rating	Target Price	Closing Price
8	26-Aug-10	*1M	360.00	320.50
9	31-Aug-10	1M	*370.00	335.27
10	14-Oct-10	*3M	370.00	394.87
11	3-Feb-11	3M	*380.00	464.00
12	4-Apr-11	3M	*420.00	479.00
13	15-May-11	3M	*430.00	440.05
14	4-Sep-11	3M	*450.00	484.20

	Date	Rating	Target Price	Closing Price
15	28-Sep-11	3M	*410.00	448.00
16	5-Oct-11	*2M	410.00	429.00
17	7-Oct-11	Stock rating system changed		
18	7-Oct-11	*2	410.00	438.68
19	5-Dec-11	2	*450.00	505.00
20	8-Jan-12	*3	450.00	526.49

Rating/target price changes above reflect Eastern Standard Time

Kumba Iron Ore Ltd (KIOJ.J)

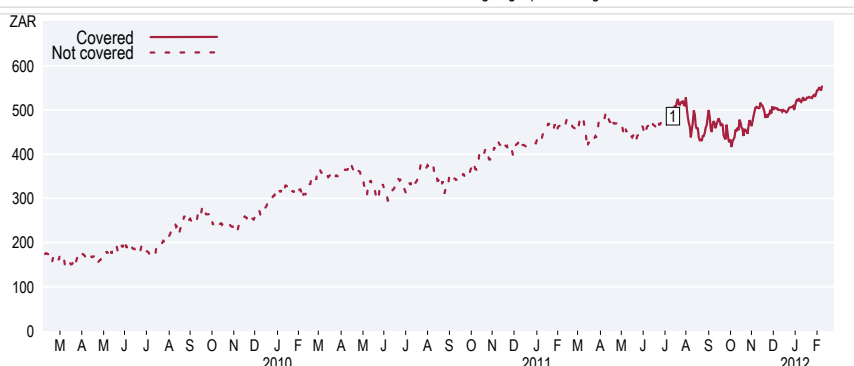
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Johann Pretorius

Covered since December 9 2009



	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD LP	-	505.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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