

Chairman's letter



Fred Roux
Chairman

Dear Shareholder

The past year has been hugely challenging and most disappointing, both from a safety performance point of view and in terms of our operating results.

Notwithstanding our considerable efforts and initiatives on the safety front, Implats has been unable to drive home a safety culture in a manner that will set it on course to achieve its objective of zero harm by 2012.

Operating performance was well below par, and together with reduced commodity prices – associated with the turmoil in world markets – culminated in a 31% reduction in rand revenue and a 52% decline in headline profit for the year.

During the year, eleven of our employees tragically lost their lives in work-related incidents, and we extend our sincere condolences to the relatives and friends of the deceased. This level of fatalities represents only a marginal improvement from the previous year, and is most disappointing in view of the considerable efforts that have been made to eliminate incidents of this nature. Lost-time incidents were maintained at similar levels in relation to the previous year and we are still a long way off from achieving the paradigm shift that we seek and will continue to pursue.

To this end, the issue of zero tolerance around non-compliance is non-negotiable – and it is non-negotiable because almost every fatality that occurs has a non-compliance connotation of some sort, albeit not necessarily by the unfortunate victim. In support of this approach, we have, and have had for some time, a work-stoppage rule in terms of which any employee may stop a workplace if it is deemed unsafe in any manner. We sincerely trust that employees will in future embrace in a meaningful way the strong message that we regard the cost of such a work stoppage as inconsequential compared with the far-reaching implications of a workplace incident.

In addition to this strong emphasis on compliance, we continue with our commitment to promoting and creating an embedded safety culture through better and more frequent training, improved communications at and between all levels of the organisation and through visible leadership. Our objective of zero harm by 2012 will be in jeopardy if our lacklustre performance this year continues, but our resolve to achieve it is greater than ever.

As shareholders well know, the near failure in the world financial system during the past year was precipitated by the export from the United States of so-called “toxic assets” that permeated financial institutions throughout the world. It is also well known that governments worldwide made available some \$3-4 trillion to defend the financial system. What is not as well known is that the particular derivative instruments that caused so much hardship represent only a tiny proportion of the total so-called over-the-counter (OTC) derivatives traded worldwide. According to the publication *The Economist*, OTC derivatives had a notional value of \$592 trillion at December 2008, with a gross market value of some \$34 trillion. The potential for violent dislocations in the world financial system is therefore self-evident, is ever-present and is, indeed, frightening. What is incomprehensible about what transpired is the failure of disclosure of risk to the shareholders of

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iconic financial institutions in a so-called era of transparency. Equally incomprehensible is the lack of focus subsequently on this non-disclosure. Shareholders will have noted that Implats, as a matter of course, makes a statement on its exposure to derivative instruments of any nature.

The build-up to the financial crisis occurred over many years before non-sustainability intervened. The particular instruments that became "toxic" were introduced by individuals and institutions almost a decade ago, and their use subsequently gained momentum. The ensuing euphoria associated with home-ownership and increasing house prices led many consumers to believe that they could afford an unprecedented consumer-buying trend that was sustained for almost ten years before the collapse. Consumption then decreased markedly in response to severe financial constraints, and was rapidly reflected in the prices of all asset classes.

For the platinum industry, the major impact of the crisis was in the automotive sector, where demand for new vehicles all but evaporated and inventory downsizing resulted in eroded demand for platinum, palladium and rhodium. Global passenger vehicle sales fell by 8.4% from an already weaker 2007 to 2008 and are likely to fall similar levels in the current year despite various vehicle scrapping incentives having been introduced around the world. The resulting price decline did, however, benefit the jewellery industry in China, where the high price of platinum in recent years had resulted in demand for the metal decreasing markedly. Lower prices also increased demand from the Japanese investment community, who purchased investment bars in unprecedented quantities. The combination of these events mitigated to some extent the excess supply brought about by lower automotive demand. In addition, the impact on the industry was further diminished by under-delivery on the supply side by virtually all producers.

The cycle of boom and bust that we have experienced in the world recently is one that is, of course, not new to the platinum industry. What is unusual about the present cycle is that it did not have its genesis in the actions of producers, who have usually precipitated downturns by major over-production. Indeed, with all the planned new platinum production by existing producers and by juniors who attempted to enter the industry, it seemed that the industry was well on its way in that direction when the massive optimism evaporated, leaving producers exposed to the higher cost base that usually accompanies such boom periods.

The financial impact of the downturn on the performance of Implats has been dramatic. Revenue in rand terms declined to R26.1 billion from R37.6 billion last year, and headline profit at R6 billion was approximately halved. More disconcerting is the fact that unit costs per platinum ounce produced increased by 31.7% to R9 129 per ounce, which seems to indicate that the group has lost the ability to contain costs and to remain the pre-eminent low-cost producer of platinum. An analysis of the cost increases is, however, instructive: approximately two-thirds of it was the result of inflation and only one-third the result of lower production.

The portion of the cost increase that resulted from inflation is to a large extent beyond the control of operating entities, and comprises cost components such as steel, explosives, fuel, coal and power. This portion of costs increased at an average rate of more than 20% per annum in response to the abnormally high demand for such goods, and there was little that management could do other than to manage it. Labour costs directly within the control of our operating entities increased by 14.6% per annum. This is significantly higher than the wage increases granted during the year, and reflects the impact of the group having to compete for the retention of skills in a mining industry that was recruiting globally. The impact of the skills shortage in South Africa was therefore exacerbated by us having to compete with job offers for skilled personnel from international companies.

I referred last year to the skills shortage and the fact that it is becoming increasingly difficult to compete as, all things being equal, an employee would be inclined to relocate to a country where crime is less prevalent, and education and healthcare are better. In addition, the vast pool of skills that we have become accustomed to in this country has diminished significantly as activity in the gold-mining sector has declined. In 1990, ore milled on South African gold mines was 129 million tonnes; by 2006, this had declined to some 53 million tonnes. Similarly, gold production declined from 603 tonnes in 1990 to 275 tonnes in 2006. The level of activity in the gold-mining industry has therefore declined by some 55% to 60%, reducing the size of the skills pool. To some extent, this decline in gold-mining activity was offset by increased production from platinum mines; but at a relatively modest 80 tonnes over the period, this increase did not quite compensate for the skills shed by the gold mines.

At present, the skills-demand situation has abated somewhat as a result of the downturn in world mining activity. However, it would

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be naïve to imagine that it would not occur again, and the group will have to position itself accordingly to ensure it has the necessary manpower and expertise to run its mining operations efficiently, and to expand operations when necessary. Regrettably, this will mean that the employee component of the cost base will have to increase, and will stay at these higher levels permanently.

I have already mentioned that under-performance on production has contributed about one-third of the increase in the cost per platinum ounce produced. To some extent, this cost increase is also due to the depletion of skills, as those individuals targeted by other companies are generally the better performers. However, management must shoulder a great deal of the blame for this production performance as poor forward planning, sub-standard delivery against production targets and poor delivery against plan on the new decline-shaft projects have been major contributory factors. Although rectification measures have been implemented and have arrested the situation, the reduced own production together with lower expected deliveries from third parties will result in total production of only some 2.1 million ounces in 2014 rather than the previously targeted 2.3 million ounces.

Given the issues that have resulted in our "underwhelming" production performance, it is appropriate at this point to mention the difficulties associated with managing in the present-day environment of enlightened democracy. The new reality is that seeking buy-in from the workforce has become ever more prevalent. This is a concept that is foreign to the mining environment in particular, where discipline has traditionally been enforced in an autocratic manner. But we have to accept that this new reality is here to stay. Our managers will have to adjust accordingly, even though it is time-consuming and somewhat debilitating to always seek some form of consensus on major issues and new initiatives. The situation is somewhat exacerbated by an entitlement attitude that now seems pervasive in our society, and leads to unrealistic expectations which often are difficult to meet. Your board is, however, confident that it has the management in place to deal with these challenges and to position the group as the employer of first choice in the mining industry.

As shareholders, you may also rest assured that your company is financially sound and is positioning itself to take advantage of the next upturn in demand – difficult as it may be now to imagine that good times will ever dawn again. The group has embarked on



Impala, Mineral Processes, Rustenburg

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a cash-preservation strategy in order to preserve its ungeared balance sheet, but capital expenditure on our major new shafts may from time to time result in relatively minor levels of debt funding. Notwithstanding the poor cost-per-ounce performance during the past year, your group remains by far the lowest-cost platinum producer. In addition, the measures that we have implemented will further improve our position as the pre-eminent low-cost producer. In this regard, we are acutely aware that complacency at a time like this is insidious, and that average performance, if condoned, will become pervasive and inevitably lead to permanent under-performance.

Looking forward, we believe that the fundamentals in the market will lead to a recovery in the medium to longer term. On this particular occasion, the recovery may take somewhat longer given the massive dent to consumer confidence and the fact that a recovery in the automobile industry – by far the largest consumer of platinum metals – will depend on consumer spending increasing by a considerable margin. The challenge in the interim is for the group to position itself to take advantage of the next upturn. Shareholders know well that we have several organic growth opportunities available to us, and we will embark on these as soon as funding constraints abate and the timing is right.

It would be remiss of me not to make mention of Zimplats and Mimoso, our operations in Zimbabwe. Despite the most unimaginably difficult business environment, they have performed admirably. At Zimplats, a new concentrator at Ngezi commenced commissioning in July this year, and will enable tonnage treated to increase to around 4 million tonnes per year and platinum-in-matte to 180 000 ounces per year. Given an improved political environment in Zimbabwe, it will be possible in due course to increase this platinum production to 1 million ounces per year. Shareholders may therefore be confident that given this organic growth potential, together with that of our South African operations, growth will not be constrained. Further opportunities to add to our resource base will continue to receive attention, as will opportunities to utilise to the fullest possible extent our smelting and refining assets for third-party processing.

Shareholders will be aware that in the recent King III report on Corporate Governance, a great deal of emphasis has been placed on the matter of Sustainability Reporting by companies. This is most appropriate, as sustainability in the mining industry is a

national imperative closely intertwined with the issue of transformation. Consequently, our social-development programmes and community-engagement initiatives will remain key as we pursue transformation related to ownership, employment equity, skills development, preferential procurement, small-enterprise development and socio-economic development. It is to be hoped, however, that the present confusion regarding changes to the recently gazetted Codes of Good Practice to the South African Minerals Industry will be clarified soon. In its present form, this document is widely regarded as controversial in that it fundamentally alters the way empowerment is conducted in South Africa. In this regard, Government should note the recent findings of the Fraser Institute, an independent Canadian research company, which every year consults some 3 000 mining companies involved in worldwide exploration and mine development. South Africa is ranked only 49th out of 71 countries in terms of its attractiveness for new mining investment. The findings also indicate that, although the South African environmental regulations and tax regime do deter investment, these factors matter far less than the issue of "uncertainty as to the interpretation of new mining legislation, regulatory inconsistencies and misgivings about land claims".

I take this opportunity to thank my fellow board members for their commitment and dedication during the past year. In particular, I thank Lex van Vught, who resigned from the board at the end of June this year. We wish him well in any future endeavours.

My personal gratitude, and that of the board, goes to David Brown and all employees in the Implats family, as well as to contractors, customers, suppliers and other business partners. This has been a difficult year for the group, but we are up to the challenges that have come our way. I am confident that with your support, we will emerge from the present downturn leaner and stronger, and ready to face future opportunities with invigorated enthusiasm.

Fred Roux
Chairman
27 August 2009