EVALUATING KUMBA RESOURCES UNBUNDLING FROM ISCOR AND STRATEGIC OPTIONS AVAILABLE POST UNBUNDLING

By

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A dissertation submitted in partial fulfilment of the requirements for the degree of the Masters in Business Administration, Graduate School of Business University of Natal

Date: February 2003

Supervisor: Prof E Thomson
RESTRICTION
Due to the confidentiality and sensitivity of the information, this dissertation should be restricted for a period of five years.

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Date: February 2003
DECLARATION

I, Patilizwe Caswell Mdoda, declare that the work presented in this dissertation is my own and has not been submitted previously to any other tertiary academic institution. Any work done by other persons has been duly acknowledged.

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ABSTRACT
Kumba Resources Ltd [Kumba], one of the largest South African-based mining companies listed on the JSE Securities Exchange, is a focused metals and mining company with a diverse commodity portfolio consisting of iron ore, heavy minerals, coal, base metals and industrial minerals.

At the unbundling of Iscor Ltd [Iscor], all the mining assets were housed under the new mining company, Kumba Resources.

The study therefore is an effort at evaluating the unbundling decision as well as options for the Kumba going forward.

The literature reviewed covers restructuring and cases on restructuring in South Africa and internationally. It outlines various methods at arriving at the competitive strength and strategic fit of company business units in a diversified environment as well as evaluating the contribution of each business unit to the profitability of the company.

All the tests applied to Kumba attest to the unbundling decision having been a good decision to take. However there are assets that have been identified that do not provide the right strategic fit in Kumba or too small and therefore destroying value like the information technology company, AST and Base Metals and Industrial Minerals Divisions.

Analysis of Kumba going forward shows that the key drivers to its growth strategy will be a focus on those commodities and investments that offer above average growth and returns while spreading the risk associated with cyclicality and volatility that characterises the supply and demand of minerals and metals in the world's major markets. Whilst the attraction of being a single commodity player because of the performance of iron ore in relation to other commodities in Kumba's portfolio, experience shows that iron ore has in the past suffered same cyclical swings particularly when the steel prices are low.

Lastly minerals and metals are a depleting resource and it is therefore advisable for the company to maintain a robust project pipeline in commodities where the company will achieve above average returns including considerations at mergers and acquisitions, critically investigate and divest in those commodities that do not provide the expected returns.
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CHAPTER ONE: INTRODUCTION

1.1 INTRODUCTION TO THE STUDY

Kumba Resources Ltd listed on the JSE Securities Exchange in November 2001 after de-merging from Iscor in July 2001. Iscor previously a parastatal was formed in 1928 to address steel requirements of a growing manufacturing industry in South Africa and was privatised in 1989.

Operating as the mining division of Iscor, Kumba has been in existence since the establishment of Iscor. Its original purpose was to supply feedstock for the steel manufacturing requirements of Iscor, namely, iron ore mined from Thabazimbi, north of Pretoria, coal mined in Hlobane and Durnacol, and other ancillary raw materials. The major milestones were the opening of the Sishen iron ore mine in the Northern Cape in 1953 and the opening of Grootegeluk coal mine in the Waterberg rim of Limpopo province [formerly Northern Province] in 1980. Both are open-pit mines and have reserves for another 30 years.

The de-merger and subsequent listing should be looked into as part of the transformation of the company and broader restructuring in South Africa.

With the privatisation of Iscor in 1989, the restriction placed by legislation limiting the company's operations to the requirements of the steel manufacturing process was removed. The mining division's asset base was broadened through acquisitions and joint ventures and, by 1994 mining had become Iscor's primary growth vehicle. The dependence of the mining division on steel requirements reduced significantly with the increase in export opportunities to Europe, China and the Far East, and by 2001 it accounted for no more than 26 percent of the division's turnover.

The restructuring of enterprises has not been confined to the public sector in South Africa. As has happened globally, it has permeated various industries. To better understand restructuring, it is important to identify actions and activities in the economy that are ascribed to as restructuring:

- Privatisation of state-owned assets and examples can be found in the partial privatisation of Telkom, the sale of state-owned radio stations and the liberalisation of the airwaves, the successful privatisation and listing of Iscor.
• Mergers and acquisitions, the high profile ones being the acquisition of the second biggest American brewer, Miller by South African Breweries plc and various other mergers and acquisitions in the financial sector in South Africa, including the merger of four South African banks, United Bank, The Trust Bank, Volkskas Bank and Allied Bank to form the biggest South African retail bank, Amalgamated Banks of South Africa (ABSA); the acquisition of Board of Executors (BoE) by Nedcor and the acquisition of Saambou by First National Bank.

Some of these mergers and acquisitions were hostile, as reflected by the failed takeover of Standard Bank by Nedcor. Some were friendly, as the successful take-over of BoE by Nedcor mentioned above has shown.

• Downsizing and outsourcing, as has happened with non-core activities of major South African companies to ensure focus and improve profitability. Popular areas of outsourcing in South Africa include security, gardening services, distribution, compensation payment management, call centre management and others.

• Divestiture as has been seen when South African Breweries divested from non-core assets like furniture businesses, retail businesses (Edgars Group) and OK Bazaars and the glass business of Autoglass and focused on beverages, gaming and hotels. These have supporting synergies that could be exploited to grow the business.

1.2 BACKGROUND TO THE STUDY

Iscor’s performance prior to unbundling was a concern of shareholders for some time resulting in the unsuccessful takeover of the Board by the Industrial Development Corporation (IDC) and partners Anglovaal Mining (AVMIN). They jointly held 26 percent of Iscor shares at the time. Though not successful, the actions led to an aggressive unbundling programme proposed by management as the alternative to the strategy proposed by the hostile suitors. The study will evaluate the success or failure of the restructuring, the unbundling initiatives and the Kumba strategy going forward.
Although the major growth of the Iscor’s mining division, later named Kumba, in the five years to the de-merger and listing came from the expansion of existing operations, it also followed an aggressive acquisition strategy. Among the significant acquisitions are the following:

1.2.1 Iron Ore
Equity in the Hope Downs iron ore project in the Pilbara region of Western Australia, with the potential to produce up to 25 million tonnes per annum (mtpa) once commissioned.

The Sishen South [formerly Welgevonden] in the Northern Cape, 70 kilometres south of the existing Sishen operations, with the potential of producing 10 million tonnes per annum once commissioned.

1.2.2 Base Metals
The acquisition of Zinc Corporation of South Africa [Zincor] from Goldfields, together with the Rosh Pinah mine in southern Namibia, made them the only integrated zinc mining and refining operations in Southern Africa. The Namibian government awarded additional licences for zinc and copper exploration in the Sperrgebiet area of Southern Namibia.

1.2.3 Heavy Minerals
The commissioning of the sand dunes mining operations, the mineral separation plant [MSP], and later a smelter in partnership with an Australian listed company Ticor Ltd and the subsequent purchase of a major shareholding in the company. Kumba has been increasing its stake in the company through purchases of stock on the open market and by the year-end [June 2001] was sitting at 49,15 percent.

On de-merger from Iscor, Kumba inherited about 30 percent shareholding held by Iscor in AST, an information technology company listed on the JSE Securities Exchange, as compensation for heavier debt allocation.

Some of the assets came about by default instead of design. They will be discussed in detail in terms of their fit and contribution to the strategic objectives of Kumba Resources.
The stated intention of the architects of the new mining company was to structure the company into four main mining divisions of Iron Ore, Coal, Heavy Minerals and Base Metals. Industrial Minerals, though non-core, has significantly assumed importance, and is now the fifth division. The divisions are structured in operationally autonomous strategic business units [SBUs].

1.2.4 Market Overview

In 2001, world iron ore production was 640 million tonnes, with South Africa contributing four percent. Sishen alone contributes 80 percent of South Africa’s seaborne iron ore trade. Demand dropped in 2002, resulting in a price decrease of 2.5 percent for fine ore and 5 percent for lump ore.

Global sea borne thermal coal supply in 2001 totalled 390.8 million tonnes with South Africa contributing 17 percent. The total supply of global seaborne coking coal [metallurgical] in 2001 was 181.2 million tonnes, with South Africa contributing one percent. Kumba’s contribution to South Africa’s coal export is small with a total of only about 1.2 million tonnes per annum exported. Exports are set to increase to three million tonnes per annum as Richards Bay Coal Terminal’s entitlement becomes available.

The titanium feedstock market, which typically lags the commodity cycle, is only now starting to be impacted by a slowdown in demand and rising supply. Prices have subsequently started to weaken while many other commodities are already recovering from their slump. Global demand for TiO2 pigment, the largest end use for heavy minerals, declined by around four percent. Several pigment plants closed down removing 74 000 tonnes of capacity. Pigment demand is expected to recover over the next five years [BJM].

Globally, a total of 6.3 million tonnes of zinc was refined in 2001; and is expected to increase to 6.4 million tonnes in 2002. It is expected that Africa will contribute two percent to 2002 global refined zinc production with the major contribution coming from Zincor [DB].
1.3 BENEFITS OF THE STUDY

All successful organisations periodically subject their processes to scrutiny by studying the environment and internal capabilities and make adjustments to bridge the gap. Such processes take the form of a strategic management process and are conducted systematically in order that a clearer understanding of issues informs future direction and brings a sharper focus on the choices available regarding options.

For Kumba, it is more important to establish the extent of success of the unbundling from Iscor in terms of what value it has added to the shareholders. Equally important is to achieve a strategic fit of Kumba assets, strategic business units, as well as effective governance structures.

Companies benchmark themselves against the best in the world to achieve best practices. Outsourcing and continuously finding ways of removing waste and gain efficiencies is also issues important to investors looking for investment destination for their funds. This needs to be balanced by nurturing and retaining core competencies to ensure that the company stays ahead of its rivals.

Similarly, mining companies need to evaluate their portfolio to ensure that they have the right mix in terms of cyclicality in their commodity portfolio performance. The process should inform external stakeholders about the nature and attractiveness of the company's operations.

The mining division of Iscor [now Kumba] was a customer needs-based company supplying Iscor with inputs for steel making process, namely iron ore, coal and dolomite. It has since moved to other commodities such as heavy minerals and base metals. This case study needs to establish what informed the company's choices, if value has been released, and to inform on the preferable commodity mix. The study should provide a stronger understanding of the value drivers and how best to respond to the investor community and ensure long-term sustainable wealth creation.

The investment community and individual investors need to continually analyse the value proposition of the company to guide their investment decisions. The study should help in updating information on the company. Students of the study of management should benefit from the study in their observance of successes and failures of strategies.
1.4 STATEMENT OF THE PROBLEM
When Kumba de-merged from Iscor, all mining assets irrespective of strategic
fit and commodity attractiveness to the new business were lumped together.
It is therefore necessary that the company establish the type of structure it
wants for the future, that it examine whether the existing portfolio fits its
growth strategies, whether it wants to be broadly diversified, focused
diversified or customer focused as concentrating on supplying the needs of a
set of customers like the steel industry.

1.5 CRITICAL QUESTIONS
The critical questions to be answered by the study in the main are as follows:

• Has unbundling and the de-merger provided Kumba with correct focus and
  added value to shareholders?

• Does the company have enough business in very attractive commodities;
  conversely is the company burdened with average to weak businesses that
  make it less competitive?

• Is the cash generating ability of the business units and the company as a
  whole able to fund future growth?

• Have the acquisitions provided the company with above average growth in
  the long term?

• Is the company’s geographic diversification providing the company with
  right balance in terms of world perception of various economies?
1.6 METHODOLOGY OF THE STUDY

Methodology used in the study will be the analysis of the prevailing factors at the time of unbundling, the current corporate strategy and identification of gaps in the current strategy.

Key issues in the current strategy were identified and analysed as follows:

- The establishment of Kumba was as a strong independent and diversified mining company with balanced portfolio of assets. The unbundling was intended to create an independent mining company cyclicality and volatility that characterise the supply and demand of minerals and metals in the world’s major markets. It is all well and good to be a single commodity player, but that creates problems when the commodity is at the bottom of the cycle and the company is making losses. The company chose a balanced approach.

- To grow the iron ore business to a strong fourth position behind CVRD, BHPBilliton, and Rio Tinto and growing the titanium dioxide business to a strong third position after Rio Tinto and Iluka.

- Ensuring that a culture of continuous improvement and operational excellence is imbedded in the company. To be able to survive, companies need to continually reduce costs and ensure value for shareholders.

- Focus on those commodities and investments that offer above average growth and returns while spreading the risk associated with them.

The key drivers of the business identified and analysed closely are the following:

- Kumba is one of four companies with significant exposure to iron ore, others being CVRD, BHPBilliton, and Rio Tinto. Consolidation of the steel manufacturing companies and the surplus supply of crude steel in the market will have an impact on future intake of iron ore.

- Cash costs of the business with half of Sishen’s costs affected by depreciation in local currency. Equally, the income is dollar denominated which off sets most of the dollar costs. The fluctuation of the currency calls for a well-structured hedging policy to protect the business and enable it to possibly benefit from such fluctuations.
• Robust project pipeline including Sishen South, Hope Downs and the Heavy Minerals project that will provide the required growth for the business in commodities that provide above average returns. Kumba has a strong cash generating capacity and would be able to fund some of these projects. Balance and restraint is, however, necessary to ensure that Kumba does not grow itself into bankruptcy.

• Export channel is owned by government with dissipate management structure. Capacity of railway line and port are a constraint to growth. Orex, the railway line that carries iron ore to the port, is owned by the state parastatal, Spoornet, the loading facility is owned by another parastatal, the South African Port Authority and operated by another, South African Port Operations. As these assets belong to Transnet, it is not a perfect situation to manage as investment decisions are delayed due to bureaucracy. This export channel plays a critical role in Kumba’s profitability and growth into the future. Over-reliance on one customer domestically for market [Iscor] could lead to problems in the future should problems develop with the relationship with Iscor. Commodities that Kumba has in its portfolio, except heavy minerals, were meant to supply steel making requirements. It is therefore natural that Iscor accounts for about 26 percent of Kumba business in all commodities. This needs to be managed to reduce Kumba’s exposure to one company.

• China question – Will the China bubble bust? China accounts for 45 percent of Kumba’s iron ore market and is growing. Its annual growth of iron ore intake has been increasing and last year grew by 29 percent. It has been importing every conceivable commodity from coal, base metals to heavy minerals. The question that is primary in industry players’ minds is: “Whether, or when, will China’s bubble bust?” To better answer the question one needs to look at key fundamentals in the Chinese economy. China’s GDP has sustained a double-digit growth for some time and has been growing its economy when other countries have been going through recession. Chinese consumption patterns have moved to luxury goods, indicating a growing middle class. The question therefore is very difficult to answer, except to advise on broader geographic diversification that would limit the company’s exposure to one country.
• The development of the Sishen South project is linked to the consolidation of the Northern Cape iron ore production that would involve the adjacent Assmang operations to generate greater efficiencies. Assmang operations are owned by Assore and Anglovaal Mining [AVMIN] and account for about 20 percent of Northern Cape iron ore operations. Single management structures can extract synergies for the benefit of all stakeholders.

• Kumba is strategically positioned to become the world's third largest producer of titanium dioxide feedstock, through investments in mining and smelting operations in South Africa, its 49.15 percent stake in Australian producer, Ticor Ltd and a 15.4 percent stake in Australian heavy minerals producer, Mineral Deposit Limited [MDL]. The successful implementation of the Heavy Minerals strategy including the takeover of Ticor Ltd is therefore very important. To be able to benefit from the exposure of the highly profitable heavy minerals business, Kumba will have to take control of cash flows. So a takeover of Ticor Ltd may be an option to pursue.

1.7 LIMITATIONS
Commodities are a very volatile and cyclical sector and any assumptions developed and recommendations made must take into effect the cycles of the various commodities. In a South African situation the currency fluctuations are a serious factor particularly with 70% of income being dollar based.
1.8 EXPLANATIONS AND DEFINITION OF CONCEPTS

1.8.1 Black Economic Empowerment: The exclusion of black people from participation in the economy resulted in a skewed economic ownership patterns necessitating interventions to redress the imbalances caused. The bias in favour of black people in economic participation to redress that situation and bring black people to the main stream of the economy is known as black economic empowerment.

1.8.2 De-merger/Unbundling: Used interchangeably in this document to mean breaking a company into separate distinct operations and ownership.

1.8.3 Extra-parliamentary organisations: The formations that developed outside the mainstream politics as a result of political exclusion before 1994 were called extra-parliamentary organisations.

1.8.4 Furnaces/Blast furnaces: Used interchangeably referring to the furnaces used as mineral smelter plants.

1.8.5 Seaborne traded iron ore: Iron ore exports.

1.8.6 Strategic Business Units/ Business Units: Used interchangeably to refer to the commodity groupings to which the company has been divided.

1.8.7 Ownership: Subsidiaries are 100% subsidiaries unless otherwise indicated.

1.8.8 Financial year: Unless otherwise stated financial year refers to the year ending June 2002.
1.9 SUMMARY


The restriction placed on Iscor by legislation limiting it to procuring only for its steel requirements expired with the privatisation of the company in 1989. Iscor's mining division later unbundled and named Kumba Resources had by the time of unbundling grown to four main commodities, namely, iron ore, coal, heavy minerals and base metals. It had also reduced its dependency on steel to no more than 26 percent.

The study recognises that companies need to continually evaluate their strategies to ensure that they are properly positioned for the exigencies of the commodity markets. Of importance, besides establishing the merits of unbundling, the study seeks to understand whether the company is invested in commodities that will provide it with above average returns.

Key drivers of the business and strategy going forward are therefore analysed to establish whether the company is positioned for sustainable growth.
CHAPTER TWO: LITERATURE REVIEW AND EVALUATION MODEL

2.1 LITERATURE REVIEW

An article by Michael Goold and Kathleen Luchs of Ashridge Strategic Management Centre on the reasons to diversify traces the chronological history of diversification strategies, from the rise of conglomerates in the fifties and sixties to the development of the synergistic portfolios built around sharing core competencies that became the school of the nineties [TSK].

The diversification strategy of the fifties was premised on the fact that managers had generic skills and business requires similar management skills. This thought presupposes that irrespective of the industry, the skills of managing people are the same. The focus was on the basic principles of management, namely planning, staffing, organising and leading. Managers were seen as able to shift with great ease at no apparent loss of effectiveness. The human and conceptual skills would make up for the unfamiliarity of the new job's technical requirements.

The wave of acquisitions in the sixties provided a testing ground for this line of thought as huge conglomerates surfaced and not only grew in size but were profitable. The conglomerates became popular not only in the United States but in Europe as well, where rave reviews were attributed to Linton Industries in terms of its technological achievements which meant the technological focus has not been lost by the generalist nature of management skills. For more than 20 years faith in general management skills justified a virtuous circle of corporate growth and diversification.

By the late sixties conglomerates were experiencing problems. Growth was no longer synonymous with profitability. Even General Electric experienced what was termed profitless growth. Company sales increased by 40 percent in 1965 – 70 and yet profits actually fell.

The concept of strategy where senior management would concentrate on taking a long-term view of the company and future direction, leaving operations to junior management, surfaced as a result of the problems experienced by the conglomerates.
Research by Joseph Bower showed a gulf between resource allocations provided by financial theory of choosing projects with the highest returns. Bower argued that projects should not be looked at project-by-project but should be related to a business product and market decision. The concept of portfolio planning where a matrix considering other factors that determine industry attractiveness developed by Boston Consulting Group was used to classify business in terms of their strategic position and opportunities. The problem experienced with portfolio management led to the recognition that different types of businesses had to be managed differently and thus undermining the argument that general management skills, buttressed by the common framework of strategy and portfolio planning, provided the rationale for diversified companies.

Scepticism cropped up in the eighties about the abilities of companies to manage and add value to diverse, conglomerate portfolios. Large companies were acquired and broken up and huge profit realised. The role of corporate management was being examined in diversified companies. What seemed more obvious about corporate management was not its contribution but its cost. Corporate services were turned into profit centres and would charge for services rendered while some companies disbanded corporate functions altogether. Porter's study showed a high rate of divestiture of acquisitions among American companies, arguing that diversification strategies of many companies had failed to create value. Also the wave of takeovers caused executives to pay increasing attention to their companies' stock price as analysts and raiders identified value gaps. Attention was now to ways of creating shareholder value. Managers were encouraged to evaluate corporate performance in the same terms as stock raiders. Value-based planning using financial tools of discounted cash flow, return on equity spreads, and hurdle rate provided corporate managers with a fresh perspective on the link between stock prices and competitive strategy. Value-based planning in a diverse group of dissimilar industries had limitations as it empowered managers with the criteria that must be met and not the how, hence the concept “stick to the knitting”, meaning concentrating on core business, gained popularity by 1982. Successful corporations did not diversify widely. They tended to specialise in particular industries and focused on improving their skills in the areas they knew best.
Restructuring therefore followed with non-core assets being disposed of. Current management thinking has focused on three main areas:-

- Diversification should be limited to those businesses with synergy where a portfolio of businesses adds up to more than the sum of its parts.

- The corporate focus should be on exploiting core competencies across different businesses where unique skills and capabilities across portfolio are enhanced.

- Successful diversification depends on building a portfolio of businesses that fit with the managerial dominant logic of top executives and their management style.

A dominant logic is the way in which managers conceptualise the business and make critical resources allocation decisions – be it in technology, production development, distribution or human resources.

No particular trend of thought has been without limitations, and it is therefore possible that a full account of corporate strategy and diversification will need to draw on several of the strands of thoughts reviewed. Diversity can only be worthwhile if corporate management adds value and that the businesses in the portfolio are worth more under the management of the company in question than they would be under any ownership.

Restructuring of state-owned assets in South Africa has been in the public domain and took more prominence since 1994 when the post liberation government recognised that it is not in the public interest for government to be running enterprises and, for that matter, it is not government’s core competence. The debate, however, was not new, as the previous government had pursued privatisation programmes despite strong opposition from the unions and then “extra-parliamentary organisations”.

The privatisation of Iscor in 1989 was one of the pre-liberation privatisation programmes undertaken by the government.
The restructuring of enterprises has not been confined to the public sector in South Africa. As has happened globally, it has permeated various industries. To better understand restructuring, it is important to identify actions and activities in the economy that are ascribed to as restructuring:

- Privatisation of state-owned assets and examples can be found in the partial privatisation of Telkom, the sale of state-owned radio stations and the liberalisation of the airwaves, the successful privatisation and listing of Iscor;

- Mergers and acquisitions, the high profile ones being the acquisition of the second biggest American brewer, Miller by South African Breweries plc and various other mergers and acquisitions in the financial sector in South Africa, including the merger of four South African banks, United Bank, The Trust Bank, Volkskas Bank and Allied Bank to form the biggest South African retail bank, Amalgamated Banks of South Africa [ABSA]; the acquisition of Board of Executors [BoE] by Nedcor and the acquisition of Saambou by First National Bank;

Some of these mergers and acquisitions were hostile, as reflected by the failed takeover of Standard Bank by Nedcor. Some were friendly, as the successful take-over of BoE by Nedcor mentioned above has shown.

- Downsizing and outsourcing, as has happened with non-core activities of major South African companies to ensure focus and improve profitability. Popular areas of outsourcing in South Africa include security, gardening services, distribution, compensation payment management, call centre management and others.

Modern institutions have expanded on the concept to include what is termed “leveraged growth”. Traditionally routes to business growth, namely, organic expansion and acquisition share a common requirement that is investment in proprietary assets. To grow organically, one builds new assets and to grow through acquisition one buys the assets to bulk up. Either way you own them.
The need to own assets, whether they are physical assets such as factories or intangible assets such as information and skills, is precisely what makes traditional growth strategies so risky. Investments are made upfront, but the pay-off does not come until later, sometimes much later. The pursuit of growth, therefore, almost always entails a narrowing of margins – for a time or, in the worst cases, forever. But there is one growth strategy that involves substantially less risk and offers the potential for an immediate and substantial boost not only in sales, but profitability. “Leveraged growth” ensures that one captures the economic benefits of growth while avoiding the economic burden of asset ownership [HBR 2000].

- Divestiture as has been seen when South African Breweries divested from non-core assets like furniture businesses, retail businesses (Edgars Group) and OK Bazaars and the glass business of Autoglass and focused on beverages, gaming and hotels. These have supporting synergies that could be exploited to grow the business.

- Various companies, including the mining division of Iscor before de-merger, have successfully achieved business engineering. The process involves reskilling and continuous improvement process and in the case of the Iscor mining division, reduced the workforce from about 17,000 to about 8,200, while adding the Zincor and Heavy Minerals division and increasing revenues;

- Unbundling, the latest example being the unbundling of the Iscor mining division now called Kumba Resources into separate and focused mining operation exploring separate growth strategies on behalf of its shareholders and

- Other forms of re-engineering can take the form of a share buy back to reduce share volatility and management buy-out deals where managers buy out non-core and, usually the non-performing or small operations of a company.

Iscor’s performance prior to unbundling was a concern of shareholders for some time resulting in the unsuccessful takeover of the Board by the Industrial Development Corporation [IDC] and partners AVMIN. They jointly held 26 percent of Iscor shares at the time. Though not successful, the actions led to an aggressive unbundling programme proposed by
management as the alternative to the strategy proposed by the hostile suitors. The study will evaluate the success or failure of the restructuring, the unbundling initiatives and the Kumba strategy going forward.

2.2 COMPANY BACKGROUND


Operating as the mining division of Iscor, Kumba has been in existence since the establishment of Iscor in 1928 as a state corporation whose aim was to promote the industrialisation in South Africa through the production of steel for the growing manufacturing industry. Its original purpose was to supply feedstock for the steel manufacturing requirements of Iscor, namely, iron ore mined from Thabazimbi, north of Pretoria, coal mined in Hlobane and Durnacol, and other ancillary raw materials. The major milestones were the opening of the Sishen iron ore mine in the Northern Cape in 1953 and the opening of Grootegeluk coal mine in the Waterberg rim of Limpopo province (formerly Northern Province) in 1980. Both are open-pit mines and have reserves for another 30 years.

With the privatisation of Iscor in 1989, the restriction placed by legislation limiting the company’s operations to the requirements of the steel manufacturing process was removed. The mining division’s asset base was broadened through acquisitions and joint ventures and, by 1994 mining had become Iscor’s primary growth vehicle. The dependence of the mining division on steel requirements reduced significantly with the increase in export opportunities to Europe, China and the Far East, and by 2001 it accounted for no more than 26 percent of the division’s turnover.

Although the major growth of the division in the five years to de-merger and listing came from the expansion of existing operations, it also followed an aggressive acquisition strategy. Among the significant acquisitions are the following:

**Iron Ore**

- The Hope Downs iron ore project in the Pilbara region of Western Australia, with the potential to produce up to 25 million tonnes per annum [mtpa] once commissioned.
• The Sishen South [formerly Welgevonden] in the Northern Cape, 70 kilometres south of the existing Sishen operations, with the potential of producing 10 million tonnes per annum once commissioned.

**Base Metals**
• The acquisition of Zinc Corporation of South Africa [Zincor] from Goldfields, together with the Rosh Pinah mine in southern Namibia, made them the only integrated zinc mining and refining operations in Southern Africa. The Namibian government awarded additional licences for zinc and copper exploration in the Sperrgebiet area of Southern Namibia.

**Heavy Minerals**
• The commissioning of the sand dunes mining operations, the mineral separation plant [MSP], and later a smelter in partnership with an Australian listed company Ticor Ltd and the subsequent purchase of a major shareholding in the company. Kumba has been increasing its stake in the company through purchases of stock on the open market and by the year-end [June 2001] was sitting at 49,15 percent.

• The acquisition of a 15,4 percent shareholding in Mineral Deposits Limited of Australia [MDL] with access to three major heavy minerals deposits in the Tamil Nadu area of India.

**Other**
• Acquisition of 35 percent interest in Mincor Resources NL [Mincor], a junior mining company listed on the Australian Stock Exchange.

• On de-merger from Iscor, Kumba inherited about 30 percent shareholding held by Iscor in AST, an information technology company listed on the JSE securities Exchange, as compensation for heavier debt allocation.

Some of these assets presented in a structure hereunder came about by default instead of design. They will be discussed in detail in terms of their fit and contribution to the strategic objectives of Kumba Resources.
The stated intention of the architects of the new mining company was to structure the company into four main mining divisions of Iron Ore, Coal, Heavy Minerals and Base Metals. Industrial Minerals, though non-core, has significantly assumed importance, and is now the fifth division. The divisions are structured in operationally autonomous strategic business units [SBUs].

**Kumba Structure**

*Figure 2.1*

Source: Kumba Resources listing document
Kumba Equity Structure

Figure 2.2

Source: www.kumbaresources.com/presentations

Background on each strategic business unit
Iron Ore Structure

Figure 2.3
During the financial year ended June 2002, Sishen and Thabazimbi mines produced 27 million tonnes of iron ore and contributed R3.3 billion to Kumba Resources revenue. Sishen accounted for 92 percent of the strategic business unit’s total production. Seventy-six percent of this production is exported through Saldanha Bay port to 35 major steel producers in Europe, China and the Far East; 19 percent is railed to Iscor’s domestic steel plants and the rest is taken by Saldanha Steel, which is now a 100 percent subsidiary of Iscor, previously a 50/50 joint venture between Iscor and Industrial Development Corporation. Iscor takes all of Thabazimbi production up.

**Kumba’s domestic iron ore trade**

*Figure 2.4*

*Source: Kumba Resources presentations*
Closely linked to the growth of the global economy and industrial production, world steel reached a record level of approximately 840 million tonnes for the 2000 calendar year. Seaborne iron ore trade rose to a record level of 454 million tonnes over the corresponding period.

Main importers in million tonnes
- Japan 132
- China 70
- Western Europe 123

Main exporters in million tonnes
- Brazil 162
- Australia 158

South Africa's export in comparison was 23 million tonnes.

Sishen is situated in the Northern Cape, about 280 kilometres north of Kimberly, and 761 kilometres from the port of Saldanha Bay. It is the world producer of lump iron ore and utilises the open pit mining method. It is linked to the deep water Saldanha harbour by an 861 kilometre railway line. It is well into a R700 million expansion programme that will increase its production to 27 million tonnes by 2003. It employs about 3 000 people. In conjunction with Transnet, the state transport utility, Kumba plans to increase the rail capacity and loading facility to handle 30 million tonnes of iron ore by 2003. The ultimate objective is to expand the rail and port facilities to handle 38 million tonnes per annum by 2007. The bulk of the bottlenecks in terms of expansion lie with the port facility. The required upgrades include the harbour, improvements in the rail line to cater for additional loops as well as additional trains and wagons. The unbundling process allocated Iscor 6.25 million tonnes per annum of the Sishen reserves, which is mined on contract by the Sishen mine at cost plus three percent. This tends to skew the efficiency calculations when determining rand cost per tonne of production. The mine has mineral reserves of 877 million tonnes and a total mineral resource of 1 724 million tonnes, providing an estimated life of a further 30 years. The mine and its related infrastructure are strategically positioned to increase share of world wide seaborne trade and market.
**Thabazimbi**

Thabazimbi mine is situated 220 kilometres north of Pretoria and has mined iron ore since 1932. It now produces 2.2 million tonnes per annum and is a captive mine, producing for Iscor Steel Product works on a long-term contract of cost plus three percent. It employs 950 people. Although the ore was previously mined underground, the mine has since been recalibrated and production comes from an open pit mine operation using electric rope shovel, front end loaders and haul trucks. The mine has haematite mineral reserves of 21 million tonnes and a total haematite resource of 91 million tonnes providing an estimated life of a further eight years.

**Prospects**

There are two main projects with feasibility studies nearing completion, namely Sishen South in the Northern Cape province and Hope Downs in the Pilbara Region of Western Australia. Sishen South is situated 70 kilometres south of the current operation in Sishen and is expected to produce up to 10 million tonnes per annum when commissioned. Production could commence by 2006.
[Next to Sishen mine [owned by Kumba] in the north [grey] are the Assmang iron ore reserves [Bruce] and next to Sishen South reserves [Kumba] lie the Beeshoek mine operations owned and managed by Assmang. Assmang takes about 4,5 million tonnes of iron ore from Beeshoek [Postmasburg] via Sishen in the north to Saldanha for export, while Kumba takes a similar amount of iron ore from Sishen in the north through the same railway line via Postmasburg for domestic use at Vanderbijlpark and Newcastle].
Hope Downs is estimated to have the potential to produce at a scale similar to Sishen, at about 25 million tonnes per annum. The project is a joint venture between Kumba and Hancock Prospecting Proprietary Limited. Kumba will operate and manage the mine and commissioning is expected by 2005. A potential stumbling block for this project is the fact that the local railway line and port facilities are privately owned. Technical feasibility studies that include a possible railway line and port facility have been completed and look positive.

On a smaller scale, Kumba owns 50 percent of magnetite iron ore deposits at Zandriversport near Polokwane [previously Pietersburg, in the Limpopo Province of South Africa]. The deposits have a high value to the steel industry because of the low alkali content and low level of phosphorous contaminants.

**Iron Ore Market Overview**

In 2001, world iron ore production was 640 million tonnes, with South Africa contributing four percent. Sishen alone contributes 80 percent of South Africa’s seaborne iron ore trade. Demand dropped in 2002, resulting in a price decrease of 2.5 percent for fine ore and 5 percent for lump ore.

**Prices**

Kumba does not negotiate directly with its major customers on pricing but follows and abides by prices agreed by the world’s major producers and importers – Brazil and the European steel manufacturers on the one hand, and Australian producers and Japanese steel producers on the other. The difference is that Kumba sets its own supply targets with the steel manufacturers, which normally is above that agreed by the major players. The net effect is that the Kumba operations run at full capacity and volumes are only constrained by infrastructural constraints and market conditions.
Coal Structure
Figure 2.6

Kumba Coal, wholly owned by Kumba Resources owns three collieries in South Africa and produces 18.2 million tonnes per annum of thermal, metallurgical and coking coal for both the domestic and export markets. The collieries are as follows:

**Grootegeluk** is situated 25 kilometres from Ellisras in the Limpopo Province and is an open pit mine that employs 2,000 people. It uses conventional shovel and truck operations producing 16 million tonnes of thermal and coking coal per annum. The mine has coal reserves of 749 million tonnes and coal resource of 10.5 billion tonnes from which semi-soft coking coal, thermal coal and metallurgical coal can be produced. Approximately 12 million tonnes per annum of thermal coal is transported to Eskom's adjacent Matimba power station by means of a seven-kilometre conveyor belt. Twenty-four years of a 40-year supply contract with Eskom remains. An additional 1.1 million tonnes per annum of non-coking coal is sold domestically to the metals and other industries on short-term contracts and to Saldanha Steel on a long-term contract while 0.3 million tonnes per annum is exported through Matola in Mozambique. An amount of 1.6 million tonnes per annum of coking coal is produced of which 1 million tonnes is railed directly to Iscor under a long-term agreement (10 years) and the remaining 0.6 million tonnes is exported through the Durban port.

**Tshikondeni** is situated 140 kilometres east of Messina in the Limpopo province. It employs 850 people and produces 433,000 tonnes of coking coal per annum. It is Kumba's only South African-based operation that is an underground operation, the other one being a zinc concentrate mine, Rosh Pinah in Namibia. It employs the conventional bord and pillar extraction method and coal is beneficiated using cyclones, spirals and froth flotation. The product is supplied to Iscor's Vanderbijlpark steel works under a long-term contract of cost plus three percent. The mine has coal reserves of 11 million
tonnes and a resource of 27 million tonnes. It is in the final phase of an expansion programme that will take production to an estimated 540 000 tonnes per annum.

Leeuwpan is situated 75 kilometres south-east of Pretoria and is a conventional open pit mine. It employs 320 people and produces 1.5 million tonnes of metallurgical coal. The principal domestic markets for the mine's production is the metals and power generating industries that consume 1.3 million tonnes per annum; the remaining 0.2 million tonnes is exported through Matola in Mozambique. Leeuwpan has reserves of 60 million tonnes and a resource of 94 million tonnes.

Prospects
The most exciting development is the securing of the Richards Bay Coal Terminal [RBCT] allocation, which will improve exporting capacity and reduce railage costs. Kumba, participating through the South Dunes Coal Terminal [SDCT] consortium, has an entitlement of two million tonnes per annum in the Phase V expansion of the Richards Bay Coal Terminal. Funding for the expansion has been secured. The initial stage of the feasibility study on the Kalbasfontein deposit near Witbank has been completed and the mine is timed to coincide with the completion of Phase V expansion. The feasibility study indicates the viability of a small open pit mine producing one million tonnes of A-grade steam coal per annum with a measured resource of 94 million tonnes.

Seaborne Coal Market Overview
The titanium feedstock market, which typically lags the commodity cycle, is only now starting to be impacted by a slowdown in demand and rising supply. Prices have subsequently started to weaken while many other commodities are already recovering from their slump. Global demand for TiO2 pigment, the largest end use for heavy minerals, declined by around four percent. Several pigment plants closed down removing 74 000 tonnes of capacity. Pigment demand is expected to recover over the next five years [BJM]. Global sea borne thermal coal supply in 2001 totalled 390.8 million tonnes with South Africa contributing 17 percent. The total supply of global seaborne coking coal [metallurgical] in 2001 was 181.2 million tonnes, with South Africa contributing one percent. Kumba's contribution to South Africa's coal export is small with a total of only about 1.2 million tonnes per annum exported. Exports are set to increase to three million tonnes per annum as Richards Bay Coal Terminal 's entitlement becomes available.
Prices
Export prices for steam coal in US dollars reached a four-year high during the first quarter of the financial year [July – September 2001]. The supply of seaborne coal in the second half resulted in sharp price reductions of around 30 percent during the fourth quarter [April – June 2001]. Domestic prices, though, rose by 15 percent. Sales to Iscor increased. Rail increases higher than PPI were experienced during the year and increases substantially higher than PPI can be expected for the next financial year.

Heavy Minerals
The product value chain that gives an idea of the flow is provided hereunder to give a better understanding of beneficiation and uses of heavy minerals.

Figure 2.7

Source: Kumba records
Pigment demand [TiO2]

More than 90% of titanium dioxide is used in the manufacture of pigments for application in coatings (paint), plastic and paper. The remaining four percent is used in metals, chemicals and glass. End use consumption is strongly linked to consumer goods and as such, pigment growth has closely tracked world GDP growth.

Titanium dioxide [TiO2] usage

Figure 2.8

Kumba is strategically positioned to become the world’s third largest producer of titanium dioxide feedstock, through investments in mining and smelting operations in South Africa, its 49,15 percent stake in Australian producer, Ticor Ltd and a 15,4 percent stake in Australian heavy minerals producer, Mineral Deposit Limited [MDL].
Kumba Resources owns 60 percent of Heavy Minerals (IHM & Tiscor) project consisting of R2,2 billion investment in the mining and treatment of heavy mineral deposits in Hillendale and the smelter plant in Empangeni near Richards Bay. The Heavy Minerals strategic business unit is responsible for developing and managing the mining and mineral separation plant operations. Tiscor is responsible for the construction and management of the Empangeni smelter that will produce titanium dioxide slag and other heavy minerals. Ticor Ltd in which Kumba has a 49.15 percent stake owns the remaining 40 percent of the project.

**Heavy minerals project is being developed in three phases as outlined hereunder:**

<table>
<thead>
<tr>
<th>Phase 1</th>
<th>Establishment of the Hillendale mine and the installation of the mineral separation plant [MSP]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 2</td>
<td>Commissioning of the smelter's first furnace at Empangeni</td>
</tr>
<tr>
<td>Phase 3</td>
<td>Establishment of the second mine at Fairbreeze and commissioning of the smelter's second furnace</td>
</tr>
</tbody>
</table>
The first phase has been completed ahead of schedule and within budget. The construction of the smelter's first furnace was more than 80 percent complete at the last financial year-end (June 2001) and will be commissioned ahead of schedule. With both furnaces in operation by 2005 the project will have the capacity to produce 250,000 tonnes of titanium dioxide per annum and substantial quantities of manganese pig iron.

The total projected capital costs of the project are R3.5 billion of which R2 billion has already been spent.

Kumba Resources increased its shareholding in Ticor Ltd to 49.15 percent by year-end, showing its clear intentions that it views heavy minerals as a growth area. In addition to its 40 percent shareholding in Ticor South Africa, Ticor is involved in a 50/50 joint venture with Tiwest, an integrated heavy minerals and titanium pigment producer in Western Australia, 100 percent of a sodium cyanide plant located in Australia at Gladstone in Queensland, and a 50/50 joint venture with Austpac Resources Ltd, which holds certain rights to large heavy mineral deposits in India.

MDL’s operations in Australia include the production of rutile, zircon and ilmenite at Hawks Nest.

**Commodity market overview**

The titanium feedstock market, which typically lags the commodity cycle, is only now starting to be impacted by a slowdown in demand and rising supply. Prices have subsequently started to weaken while many other commodities are already recovering from their slump. Global demand for TiO2 pigment, the largest end use for heavy minerals, declined by around four percent. Several pigment plants closed down removing 74,000 tonnes of capacity. Pigment demand is expected to recover over the next five years [BJM].

**Pricing**

The titanium dioxide market is relatively stable from a pricing perspective, predominantly due to the very small number of players (both producers and consumers), and the fact that demand generally runs in line with global GDP growth trends. It is therefore not traded on the spot market and players enter into long-term contracts.
The Base Metal Strategic Business Unit [SBU] comprising Rosh Pinah mine in southern Namibia and the electrolytic refinery, Zincor near Springs in Gauteng province, South Africa, is the only integrated zinc mining and refinery operation in southern Africa. Zincor enjoys the distinction of being one of the lowest cost operators of its type in the world.

Despite the over supply of zinc metal, Zincor operated at close to full capacity throughout the financial year, producing 105,000 tonnes of zinc metal and 167,000 tonnes of sulphuric acid. It draws 36 percent of its zinc concentrate from Rosh Pinah. The rest is procured domestically supplemented by periodic imports. Approximately 30 percent of Zincor’s total sales go to Iscor’s steel works at Vanderbijlpark. The majority of sales are made to customers in a 100-kilometre radius in galvanising, zinc-alloy and zinc chemical industries.

Rosh Pinah is an underground operation employing 465 people and produces 27,000 tonnes of zinc concentrate with small quantities of silver, gold and copper as by-products. All its zinc production is sold to the Zincor refinery and the lead concentrate is sold on the basis of tender to international markets. Through improved extraction methodology, the mine was able to extend its expected economic life by three years to ten years.

Prospects

The Hongye refinery located near Chifeng in the Inner Mongolia autonomous region some 350 kilometres north-east of Beijing was built in 1995 to a design similar to Kumba’s Zincor refinery, with a capacity of 25,000 tonnes per annum. Kumba has agreed with the current shareholders that it will participate in an expansion of the project. Successful implementation of the project will provide Kumba Base Metals with a platform for leveraging future growth in China.
Kumba has an opportunity to participate in the development of developed and undeveloped copper and zinc resources in Kamoto and Kipushi in the Democratic Republic of the Congo. Deposits in these mines are the richest by any standards. Political instability in the Democratic Republic of Congo makes it difficult for any form of operations to take place.

**Zinc Market Overview**
Globally, a total of 6.3 million tonnes of zinc was refined in 2001; and is expected to increase to 6.4 million tonnes in 2002. It is expected that Africa will contribute two percent to 2002 global refined zinc production with the major contribution coming from Zincor [DB].

**Prices**
The zinc price reached its lowest levels in more than 15 years in November 2001. While the downward cycle might appear to have bottomed, and prices have improved marginally, substantial increases are not expected within the next year. Despite the weak United States' vehicle sales, there has been renewed interest in zinc from the US steel industry and Asian demand has begun improving against a backdrop of lower Chinese exports. The market fundamentals remain weak in the short to medium term [DB].

Depreciation of the rand against the dollar together with integration of mining and refining appear to be the salvation of the operations and keep the business unit profitable.

**Other assets and investments**
Kumba's interest in industrial minerals is confined to the Glen Douglas open pit mine producing metallurgical dolomite, aggregate and small quantities of agricultural lime; a ferrosilicon powder plant, superior in quality to the product currently on the market and 50 percent of the Bridgetown dolomite mine joint venture. The operations are profitable and strategically positioned to the beneficiation needs at the company's iron ore mines while dolomite is supplied to Iscor. The Glen Douglas dolomite mine has a proven reserve of 25 years at the current rate of operations.

**Mincor Resources NL [Mincor]**
Kumba has a 34.5 percent interest in Mincor, which is a junior mining and exploration company listed on the Australian Stock Exchange. Mincor has an interest in the Reqo Diq copper deposits in western Pakistan and in gold prospects in Fiji, Tanzania and Guinea.
**AST Group**

Kumba Resources Ltd holds 30.7 percent equity in a non-performing information technology company listed on the JSE Securities Exchange. The shares were inherited at the time of unbundling as compensation for heavier debt allocation between mining and steel.

### 2.3 EVALUATION MODELS

The organisation will be placed in context by reviewing the major forces that could influence it in the environment and in particular the industry.

#### 2.3.1 Industry attractiveness evaluation

Five business unit heads in Kumba Resources were asked to rate the parameters they considered most important in determining attractiveness of an industry. The top six were rated and are provided hereunder to be used as a factoring measure:

**Assigned ratings of key areas by senior management**

**Table 2.2**

<table>
<thead>
<tr>
<th>Area</th>
<th>Assigned Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash operating margins</td>
<td>6</td>
</tr>
<tr>
<td>Market/industry size &amp; projected growth</td>
<td>6</td>
</tr>
<tr>
<td>Intensity of competition &amp; ease of substitution</td>
<td>4</td>
</tr>
<tr>
<td>Degree of risk (PEST) price volatility &amp; trends</td>
<td>3</td>
</tr>
<tr>
<td>Emerging industry opportunities and threats</td>
<td>2</td>
</tr>
<tr>
<td>Strategic fit &amp; resource fit</td>
<td>2</td>
</tr>
</tbody>
</table>
2.3.1.1 Attractiveness of each industry

Table 2.3

<table>
<thead>
<tr>
<th>Industry attractiveness factor</th>
<th>Iron</th>
<th>HM</th>
<th>Coal</th>
<th>BM</th>
<th>IM</th>
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<tbody>
<tr>
<td>Cash operating margins</td>
<td>A</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td>Market &amp; industry</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>O</td>
<td>X</td>
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<td>Risks</td>
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<td>X</td>
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<tr>
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<td>O</td>
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<td>A</td>
<td>X</td>
</tr>
<tr>
<td>Industry &amp; resource fit</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
<td>A</td>
</tr>
</tbody>
</table>

A: Attractive  O: Neutral  X: Unattractive

2.3.1.2 Analysis and comment

Iron ore followed by coal, and then heavy minerals show strong attractiveness. Base metals and industrial minerals whilst not showing an entirely unattractive rating are not as attractive and need further investigation and possible divestiture decision might have to be taken.

2.3.2 Evaluating the competitive strength of each of the business units

Six business unit heads in Kumba Resources were asked to rate the parameters they considered most important in determining competitive strength of the business units. The top six were rated and are provided hereunder to be used as a factoring measure:

Competitive strength assigned rating by senior management

Table 2.4

<table>
<thead>
<tr>
<th>Parameter</th>
<th>6</th>
<th>4</th>
<th>2</th>
<th>5</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative market share</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Brand name and reputation</td>
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<tr>
<td>Cost Leadership and Profitability</td>
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<tr>
<td>Bargaining leverage with suppliers</td>
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<tr>
<td>Technology and innovation capabilities</td>
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<tr>
<td>Competitive assets and competitiveness</td>
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</tbody>
</table>
### Weighted rating

**Table 2.5**

<table>
<thead>
<tr>
<th></th>
<th>Iron Ore</th>
<th>Heavy Mineral</th>
<th>Coal</th>
<th>Base Metal</th>
<th>Industrial Minerals</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>W R WR</strong></td>
<td>0.40  6  2.40 0.25  6  1.50</td>
<td>0.29  6  1.74</td>
<td>0.10  6  0.60</td>
<td>0.05  6  0.30</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.25  6  1.50 0.05  6  0.30</td>
<td>0.20  6  1.20</td>
<td>0.10  6  0.60</td>
<td>0.05  6  0.30</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.10  4  0.40 0.30  4  1.20</td>
<td>0.05  4  0.20</td>
<td>0.10  4  0.40</td>
<td>0.05  4  0.20</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.05  2  0.10 0.05  2  0.10</td>
<td>0.30  2  0.60</td>
<td>0.45  2  0.90</td>
<td>0.50  2  1.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.05  5  0.25 0.30  5  1.50</td>
<td>0.11  5  0.55</td>
<td>0.15  5  0.75</td>
<td>0.05  5  0.25</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.15  4  0.60 0.05  4  0.20</td>
<td>0.05  4  0.20</td>
<td>0.10  4  0.40</td>
<td>0.30  4  1.20</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5.25</td>
<td>4.80</td>
<td>4.49</td>
<td>3.65</td>
<td>3.25</td>
</tr>
</tbody>
</table>

**Legend**

- **W**: Factor weight distributed among the six factors according to their importance in the particular category. Sum total should be 1.
- **R**: Measurement as determined in Table 2.4 rated from 1 -10, where 1 represents less attractive and 10 more attractive.
- **WR**: Weighted rating arrived at by multiplying the rating and factor weight to get the score of each.

### 2.3.2.1 Analysis of the competitive strength of each of the company's business units

A detailed review of the competitive strength of each of the company’s business units will be discussed under different headings.

**Iron Ore**

Of the 28.3 million tonnes produced during the financial year, Sishen produced 91% and about 20 million tonnes of that was exported through Saldanha Bay, earning dollar income. While this accounts for only four percent of seaborne traded iron ore in the world, it accounts for a major portion of lumpy ore produced and used by most of the steel manufacturers in the world to blend their stock feed.
Domestic supply has not been taken into account as it is supplied to Iscor at cost plus three percent. Of the five percent world supply of iron ore supplied by South Africa, Kumba iron ore supplies four percent. The weighting has been worked in relation to South African producers. Two projects that have completed their technical feasibility studies – Sishen South and Hope Downs – make the iron ore business unit much more attractive and competitive compared to the others. These two projects, added to the expansion programme at Sishen, can take Kumba to 75 million tonnes per annum and put it in a strong fourth position in seaborne traded iron ore. Consolidation of the Northern Cape iron ore production can add another five million tonnes per annum, taking it to 80 million tonnes per annum.

Sishen beneficiates its iron ore, making it less efficient on cost of production, but enabling it to supply a premium lumpy product that fetches above average price and is sought after. The weight given here is therefore 0,20. Sishen iron ore is a known brand and sought after worldwide. Weight assigned therefore is 0,10 affected by the comparative size of supply. Being a small supplier, the company is a price taker instead of a price setter and weight assigned is therefore 0,05.

The business unit has developed electric rope shovels, front-end loaders and electrified haul trucks for its operations, significantly reducing the consumption of diesel and therefore dollar denominated costs. Though it cannot be regarded as a technological leader, the unit rates very well and is given a 0,05 weight.

Iron ore has an attractive project pipeline that guarantees growth should the projects be implemented. The business unit is also extremely competent in open-pit mining and the weight assigned is a credible 0,10.

**Heavy Minerals**

Kumba is conducting its heavy minerals business through Ticor Ltd where it has a 49,15 percent equity ownership and 60 percent ownership of a project jointly owned with Ticor Ltd in Empangeni. The Ticor/Kumba partnership is destined to be the third biggest producer of titanium dioxide by 2006 when both furnaces are fully commissioned at Empangeni. Current feedstock production is stockpiled to coincide with major contracts coming into operation in 2006 [Kumba]. The weight takes into consideration this growth possibility and is assigned a market weight of 0,25. Long-term contracts
signed took into effect that there is currently an oversupply in the market and a weight of 0.05 is assigned. There is no particular strength in bargaining leverage and it is therefore assigned a weight of 0.05. Ticor has considerable strength and a good track record in technology in the heavy minerals industry. All phases of the Empangeni project, including the smelter furnace, have been completed ahead of schedule. A weight of 0.30 is assigned. Ticor/Kumba partnership has assets/prospects worldwide particularly in Australia, South Africa and East Asia and a weight of 0.05 is assigned.

Coal
Coal has a strong domestic market with long-term contracts with Iscor and Eskom. Supply chain capacity in South Africa – particularly involving rail and port – makes it difficult for Kumba to fully exploit the international market. The Kumba coal market position is displayed on the graph below and reflects an overall producer situation of eight percent and a weight is worked out relative to the major producer [Ingwe Coal] at 8/28 = 0.29.

Graph of coal domestic producer position
Figure 2.11

SA Coal Producers
Kumba has been a leader in introducing re-engineering programmes and one such programme has resulted in significant efficiencies at Grootegeluk. A weight of 0.20 is assigned. There is no significant branding of the product save for a small quantity of coking coal which is a requirement of the steel manufacturing process and supplied by Tshikondeni Colliery to Iscor. A rating of 0.05 is assigned. Long-term contract with Iscor and Eskom secure long-term production and prices are based dollar denominated basket of goods. A weight of 0.30 is assigned.

Coal benefited from the re-engineering and skills developed has made Kumba coal a leader in open pit mining, extracting significant efficiencies. Grootegeluk is regarded as one of the lowest cost producers in the industry. A weight of 0.11 is assigned.

Base Metals
Market share is confined mainly to domestic consumers such as Iscor and the unit operates as the only zinc refinery in South Africa. There is currently little export and is weighted very low at 0.10. It has managed to be profitable mainly due to strict cost cutting and depreciation of the rand against the dollar.

There is no identifiable brand strength outside the existing market and a weight of 0.10 is assigned. There is very little leverage with customers and the business unit relies mainly on the integrated supply of zinc concentrate from Rosh Pinah [95 percent owned by Kumba]. A weight of 0.45 is assigned. Zincor refinery brought technology it inherited from its links with Goldfields and there has been mainly a maintenance exercise. Zinc extraction methods, however, are on par with the industry. A weight of 0.15 is assigned. Except for prospects in the expansion of the mine and its surroundings there are no significant local prospects and feasible projects. Exciting projects are in the Democratic Republic of the Congo, which is bedevilled by political instability. A weighted rating of 0.10 is assigned.

Industrial Minerals
Mining of dolomite at Glen Douglas is mainly on contract basis to Iscor and has very little market beyond this and is assigned a weight of 0.05. Though profitable, it is too small to be a significant player and a weight of 0.05 is assigned. There are no branding possibilities and having one major customer does not give an opportunity to establish a reputation outside that relationship. A weight of 0.05 is assigned. As the only reputable supplier to
Iscor, it has some leverage and is assigned a weight of 0.50. Its biggest dolomite mine has an expected 25-year life and is assigned a weight rating of 0.30.

2.3.2.2 Conclusions
Iron ore [5,25] leads followed by heavy minerals [4,80], coal [4,49], base metals [3,65] and industrial minerals [3,25], showing the strength of the commodity in the life of the company. Though still in its early stages of development, heavy minerals show huge potential. Coal provides the required annuity income and is a cash cow for the company. Careful consideration will have to be given to base metals and industrial minerals. While they are still making profits they could be a drain as a result of the disproportional resources and time given to them.

2.3.3 Comparative strength indicators
The top 20 senior management of Kumba Resources were asked to rate the comparative strength of the company on six parameters. The results are outlined here on a scale of 1 – 10 [where 1 represents weak and 10, strong].

<table>
<thead>
<tr>
<th>Comparative strength indicators assigned rating by senior management</th>
<th>Table 2.6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowledge of markets and customers</td>
<td>7</td>
</tr>
<tr>
<td>Production/Beneficiation capabilities</td>
<td>4</td>
</tr>
<tr>
<td>Skills in supply chain management</td>
<td>8</td>
</tr>
<tr>
<td>Marketing skills</td>
<td>7</td>
</tr>
<tr>
<td>Financial resources management</td>
<td>7</td>
</tr>
<tr>
<td>Proven know-how in management of business</td>
<td>8</td>
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</tbody>
</table>
2.3.3.1 Competitive strength of each business unit on a nine-cell industry attractiveness-competitive strength matrix using the rating.

Table 2.7

<table>
<thead>
<tr>
<th></th>
<th>Strong</th>
<th>Average</th>
<th>Weak</th>
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<tbody>
<tr>
<td>High</td>
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<td>Med</td>
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<tr>
<td>Low</td>
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</tbody>
</table>

Competitive Strength

● Iron ore
■ Heavy minerals
@ Coal
# Base metals
0 Industrial minerals

2.3.3.2 Analysis and comments

The nine cell matrix to simultaneously portray the attractiveness and competitive strength of the group business units shows a very strong position for iron ore followed by heavy minerals and coal and therefore high priority for investment. Base metals and industrial minerals fall in the area considered low priority for investment.
2.3.4 Strategic fit analysis
The governance structure of the company is made up of three layers, namely, the Corporate Centre, the strategic business unit that groups the mines of a similar commodity and business units referring to the individual mines. For the purpose of this document strategic business units and business units have been used interchangeably to refer to commodity divisions. The synergy between the functions of the business units was evaluated to get inclination as to an optimal structure of the group and the table hereunder reflect an aggregated position. Five business unit heads participated.

Strategic fit assigned rating by senior management
Table 2.8

<table>
<thead>
<tr>
<th>Skills matching and utilisation</th>
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<tbody>
<tr>
<td>Administration/Financial</td>
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<td>4</td>
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<tr>
<td>Technology</td>
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<td></td>
<td>8</td>
</tr>
<tr>
<td>Sales and Distribution</td>
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<td></td>
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<td>4</td>
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<tr>
<td>Operations</td>
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<tr>
<td>Strategy/Business plans</td>
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<td>5</td>
</tr>
</tbody>
</table>

2.3.4.1 Analysis and Comment
To gain insight into the operations of the organisation and the various factors that contribute towards its effectiveness a detailed discussion will follow.

2.3.4.1.1 Skills matching and utilisation
Kumba uses a rotation system to ensure that senior management is exposed to all the operations of the group. A career board looks across the company when promotions are made. The survey therefore shows a strong fit.

2.3.4.1.2 Administration/Finance
There is very little sharing as standard practices are followed and financial reporting is done separately and consolidated centrally.
2.3.4.1.3 Technology
A central corporate technology department operating as a profit centre and providing services to all business units and charging for services rendered is in existence to ensure maximum benefit for all business units.

2.3.4.1.4 Sales and distribution
There is only one major common customer [Iscor] negating any form of collaboration and synergy extraction. Distribution infrastructure for major bulk commodities belongs to one supplier and managed separately and as a result no collective influence can be exercised.

2.3.4.1.5 Operations
Standing forums to share best practices are in existence and effectively used.

2.3.4.1.6 Strategy/Business plans
Business units develop their business plans and get co-ordinated at corporate level in terms of resource allocation. There is a level of cross subsidisation making it impossible for business units to be entirely independent.

2.4 SUMMARY
The history, forms and literature on restructuring, both in South Africa and internationally is analysed. Successes and failures are studied to help establish parameters for the evaluation of the unbundling case and future prospects for Kumba.

The analysis of the business units and prospects in various commodities show that the company has good assets and a robust project pipeline that is the mainstay of sustainable mining operations. The company also has a good geographic customer profile with customers in China, Far East and Europe.

The strong influence of iron ore in the bottom-line is chronicled as well as the contributions made by coal and future growth expected from heavy minerals. Analysis models used confirm this point and further prove a strong fit of the commodities with the exception of base metals, which has experienced slump in prices for a considerable period.
CHAPTER THREE: EVALUATING THE CORPORATE STRATEGY

3.1 INTRODUCTION

The establishment of Kumba was as a strong independent and diversified mining company with balanced portfolio of assets. The unbundling was intended to create an independent mining company cyclicality and volatility that characterises the supply and demand of minerals and metals in the world's major markets. It is all well and good to be a single commodity player, but that creates problems when the commodity is at the bottom of the cycle and the company is making losses. The company chose a balanced approach:

To grow the iron ore business to a strong fourth position behind CVRD, BHPBilliton, and Rio Tinto and growing the titanium dioxide business to a strong third position after Rio Tinto and Iluka;

Ensuring that a culture of continuous improvement and operational excellence is imbedded in the company. To be able to survive, companies need to continually reduce costs and ensure value for shareholders;

Focus on those commodities and investments that offer above average growth and returns while spreading the risk associated with and

In the context of legislative environment in South Africa, to actively pursue strategies that would result in meaningful and sustainable Black Economic Empowerment in all facets of the business.
Figure 3.1 gives the global supply situation of titanium dioxide. Five companies produced 85% of feedstock in 2001.

Titanium dioxide feed stock producers

Figure 3.1

![Global TiO2 feedstock producers](image)

Source: Kumba records

3.2 IDENTIFYING KEY DRIVERS AND SUCCESS FACTORS

Kumba is one of four companies with significant exposure to iron ore, others being CVRD, BHPBilliton, and Rio Tinto. Consolidation of the steel manufacturing companies and the surplus supply of crude steel in the market will have an impact on future intake of iron ore.

Cash costs of the business with half of Sishen’s costs affected by depreciation in local currency. Equally, the income is dollar denominated which off sets most of the dollar costs. The fluctuation of the currency calls for a well-structured hedging policy to protect the business and enable it to possibly benefit from such fluctuations.

Robust project pipeline including Sishen South, Hope Downs and the Heavy Minerals project that will provide the required growth for the business in commodities that provide above average returns. Kumba has a strong cash generating capacity and would be able to fund some of these projects. Balance and restraint is, however, necessary to ensure that Kumba does not grow itself into bankruptcy.
Export channels are owned by the government with dissipate management structure. Capacity of railway line and port are a constraint to growth. Orex, the railway line that carries iron ore to the port, is owned by the state parastatal, Spoornet, the loading facility is owned by another parastatal, the South African Port Authority and operated by another, South African Port Operations. As these assets belong to Transnet, it is not a perfect situation to manage as investment decisions are delayed due to bureaucracy. This export channel plays a critical role in Kumba's profitability and growth into the future.

Over-reliance on one customer domestically for market [Iscor] could lead to problems in the future should problems develop with the relationship with Iscor. Commodities that Kumba has in its portfolio, except heavy minerals, were meant to supply steel making requirements. It is therefore natural that Iscor accounts for about 26 percent of Kumba business in all commodities. This needs to be managed to reduce Kumba's exposure to one company.

China question – Will the China bubble bust?
China accounts for 45 percent of Kumba's iron ore market and is growing. Its annual growth of iron ore intake has been increasing and last year grew by 29 percent. It has been importing every conceivable commodity from coal, base metals to heavy minerals. The question that is primary in industry players' minds is: "Whether, or when, will China's bubble bust?" To better answer the question one needs to look at key fundamentals in the Chinese economy. China's GDP has sustained a double-digit growth for some time and has been growing its economy when other countries have been going through recession. Chinese consumption patterns have moved to luxury goods, indicating a growing middle class. The question therefore is very difficult to answer, except to advise on broader geographic diversification that would limit the company's exposure to one country.
The development of the Sishen South project is linked to the consolidation of the Northern Cape iron ore production that would involve the adjacent Assmang operations to generate greater efficiencies. Assmang operations are owned by Assore and Anglovaal Mining and account for about 20 percent of Northern Cape iron ore operations. Single management structures can extract synergies for the benefit of all stakeholders.

The successful implementation of the heavy minerals strategy including the takeover of Ticor Ltd. To be able to benefit from the exposure of the highly profitable heavy minerals business, Kumba will have to take control of cash flows. So a takeover of the company may be an option to pursue.
3.3 SWOT ANALYSIS

An analysis of the business was conducted to better understand its strengths and weaknesses as well as, opportunities and threats.

3.3.1 Kumba resources strength and weaknesses

Table 3.1

<table>
<thead>
<tr>
<th></th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>External</strong></td>
<td>• Centre of investment attention</td>
<td>• Target for takeover</td>
</tr>
<tr>
<td></td>
<td>• No legacy of environment damage</td>
<td>• Low influence in supply chain</td>
</tr>
<tr>
<td></td>
<td>• Attractive investment proposition</td>
<td>• No track record in investor community</td>
</tr>
<tr>
<td></td>
<td>• Government support for SA based mining company</td>
<td>• High supply chain costs</td>
</tr>
<tr>
<td></td>
<td>• Strong corporate governance</td>
<td>• No access to offshore gearing</td>
</tr>
<tr>
<td></td>
<td>• Good social programmes</td>
<td>• Black Economic Empowerment strategy not well defined</td>
</tr>
<tr>
<td></td>
<td>• Ability to influence external environment</td>
<td>• Lack of strategic alliance</td>
</tr>
<tr>
<td><strong>Markets</strong></td>
<td>• Research and development strength [furnace smelter]</td>
<td>• Strong iron ore exposure</td>
</tr>
<tr>
<td></td>
<td>• Independent of the big three but reliable supplier</td>
<td>• Exposure to China</td>
</tr>
<tr>
<td></td>
<td>• Integrated business in zinc production</td>
<td></td>
</tr>
<tr>
<td><strong>Internal</strong></td>
<td>Balanced portfolio of quality assets</td>
<td>• Lack of critical mass [size]</td>
</tr>
<tr>
<td></td>
<td>• $Based income and Rand based costs</td>
<td>• Long lead time in project pipeline</td>
</tr>
<tr>
<td></td>
<td>• Technology/Business development skills/Research and development</td>
<td>• Geographic concentration [emerging markets perception]</td>
</tr>
<tr>
<td></td>
<td>• Efficient operations/ Low on mine costs</td>
<td>• No control of heavy minerals operations and yet identified as growth area</td>
</tr>
<tr>
<td></td>
<td>• Competent people</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Strong cash flows/Low gearing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Strong project pipeline</td>
<td></td>
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<tr>
<td></td>
<td>• Culture of continuous improvement</td>
<td></td>
</tr>
</tbody>
</table>
3.3.1.1 Analysis of key strengths
Key strengths that could be leveraged for growth and weaknesses that require attention are highlighted and discussed. Others are collectively discussed in the recommendations.

3.3.1.1.1 Attractive investment proposition
Kumba is an attractive investment proposition and the project pipeline is very attractive and can be easily funded. Aggressive selling of the project pipeline to prepare investment community is necessary.

3.3.1.1.2 Government support for South African based mining company
Government has shown support for new South African based mining companies with all the majors having migrated to New York and London in terms of listing. This can make the process of conversion of licences required by new legislation [Mineral and Resources Development Act] move much smoother than in other companies.

3.3.1.1.3 Independent of the ‘big three’ and yet reliable supplier
The price collusion by the major producers, namely, Rio Tinto, CVRD and BHPBilliton has made the consumers to search for alternatives. With further consolidation expected, the market would prefer an independent Kumba. Kumba currently sells all what it produces. Independent status should be retained and leveraged.

3.3.1.2 Analysis of key challenges
The business also faces key challenges that will require attention to reduce risks it is exposed to.
3.3.1.2.1 **Low influence in supply chain decisions**
Bureaucratic processes in arriving and refinancing and expansion of the rail and port facilities [owned by Transnet] have adverse impact on efficiencies and growth. This however creates an opportunity for the company to explore concessioning proposal with government who is Transnet shareholder. Government is not keen on outright sale [Department of Public Enterprise restructuring strategy].

3.3.1.2.2 **Lack of critical mass**
Growth can be achieved through generating good cash flows from existing assets or by bulking up by buying other companies to create a balance sheet that make it possible to raise funding. Profitless growth is sometimes dangerous as it compromises the debt/equity ratios and long-term sustainability of the company. Kumba needs to strike a balance, as it does not have a huge balance sheet to back it up.

3.3.1.2.3 **No control of heavy mineral operations**
Kumba has identified heavy minerals as a growth area. It is however executing its strategy through Ticor Ltd and has no operational control. This limits the company, as it cannot use its efficiency programmes and balance sheet to effect growth. Kumba needs to take immediate action and take control of the business to effectively benefit from the cash flows and balance sheet to implement its growth programmes.
# 3.3.2 Kumba Resources opportunities and threats

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
</table>
| **Government** | • Public/private partnership in NEPAD  
• South African mining champion  
• Eskom deregulation  
• Coega development |
| | • Investor uncertainty [legislation]  
• Pace of privatisation  
• Lack of coherent transport regime to support business  
• Eskom deregulation |
| **Africa** | • Rapid growth from a low base  
• Infrastructure roll out  
• Geographically and politically best placed  
• NEPAD/Pioneering skills |
| | • US$ costs of doing business  
• Poor knowledge of Africa  
• Governance  
• Stability |
| **Legislative Requirements** | • JV opportunities  
• New resources available |
| | • Perception of destruction of shareholder value  
• Loss of Northern Cape reserves  
• New entrants |
| **Markets** | • China iron ore/heavy minerals  
• Opportunity with Eskom |
| | • China failure  
• Entry of BEE parties |
| **Beneficiation** | • Increase Ticor holding |
| | • Unfocussed integration to meet legislative requirements |
| **Capital** | • Commodity synergies with Anglo  
• Increase Ticor shareholding to develop offshore funds |
| | • Limited ability to raise capital  
• Lack of understanding of intentions of anchor shareholders |
| **Supply chain** | • Initiate concessioning  
• RBCT participation  
• Influence re-investment strategy |
| | • Lack of control  
• Uncertainty around Sishen-Saldanha rail line |
| **Reserves** | • Access to new reserves  
• Northern Cape consolidation |
| | • Loss of reserves [M&PRDA]  
• Inability to consolidate Northern Cape |
3.3.2.1 Analysis of key areas of opportunity
The company needs to exploit all opportunities available to it. A synopsis of available opportunities is highlighted and discussed.

3.3.2.1.1 Geographically placed
Kumba is geographically well placed to have a better understanding of the African continent and exploit the vast untapped reserves. The South African government initiatives around New Partnership for Africa Development [NEPAD] provide the right political framework for participation. Africa is coming from a low base of development creating an opportunity for better margins.

3.3.2.1.2 Commodity synergy with Anglo-American plc
Anglo is a significant shareholder in Kumba Resources and has almost the same commodity portfolio and aspirations in iron ore. Synergies could be exploited to benefit both companies.

3.3.2.1.3 Access to new reserves
The use it or lose it principle of the Mineral Act will provide access to new mineral resources that the current holders may not be able to exploit.

3.3.2.2 Analysis of major threats
Major threats facing the company are outlined and discussed hereunder for the company to better understand and devise strategies to handle or circumvent risks presented.

3.3.2.2.1 Loss of reserves
Kumba can lose prime reserves if there are no immediate plans to use them. A process needs to be put in place to identify prime areas and make plans. A protracted process of retention debates can affect investor confidence.

3.3.2.2.2 HIV/AIDS Pandemic
Lack of extensive understanding of the impact of HIV/AIDS in the work place is a major shortcoming not only for Kumba but the industry as a whole. Uninformed responses by companies for public relations exercise may not help in finding a long-term solution. A thorough study of the situation is necessary.
3.4 PAST PERFORMANCE AND FUTURE PROSPECTS

An extract of results of the then mining division of Iscor from 1998, combined with the first year performance as an independent company [June 2002], indicates a trend of consistent performance and growth. A brief analysis of the performance is highlighted in Figure 3.3 below.

It is clearly evident from graph that the company's focus as a result of the de-merger had a significant impact in the profitability of the company. Though the mining division had acceptable average growth to 2001, the jump of about 33 percent growth in revenue and 188 percent growth in operating profit is by any means phenomenal and vindicates the decision to unbundle.

Figure 3.3
Five year revenue and operating profit figures

Source: Kumba resources analyst presentation, August 2002

3.5 SUMMARY

The company has good quality assets and the strategy followed adds significant value to stakeholders. Challenges as identified by the SWOT analysis needs close scrutiny. The dominance of China as a market might not pose an immediate threat, however, diversification into other global markets will require to be pursued aggressively.
CHAPTER FOUR: CONCLUSIONS AND RECOMMENDATIONS

4.1 INTRODUCTION

Kumba Resources has performed extremely well since de-merger from Iscor in November 2001. The company has high iron ore exposure and as has been depicted in the attractiveness test, it is highly profitable. The significant margins in the iron ore business unit, coupled with the depreciation of the rand against the dollar, have driven the strong financial performance. The company has, as a result, outperformed the indices of iron ore exposed companies as shown by in Figure 4.1 below.

Figure 4.1
Share price performance

![Share price performance chart]

Source: Bloomberg

This has attracted extensive corporate activity with BHPBilliton, Rio Tinto and Anglo-American plc showing interest with Anglo ultimately making a move for 20,1 percent of the company equity holding with a strong indication that it wants to broaden its interest in iron ore.

Kumba has a strong balance sheet, having reduced the debt inherited on unbundling from R2,5 billion to R1,1 billion at the end of the last financial year.
The de-merger from Iscor realised significant shareholder value and made sure that both companies are focused. They both posted good results at the end of the financial year [June 2002]. Figure 4.2 below demonstrates the amount of value released as a result of unbundling.

**Figure 4.2**

**Kumba/Iscor share price at unbundling**

Liquidity in both stock shares increased since the unbundling.

![Chart showing share price comparison between Iscor and Kumba before and after unbundling.]

Source: JSE

**Analysis and comment**

Just prior unbundling Iscor's share price [steel and mining] was trading at +R28,00. At unbundling both companies were re-rated with Kumba coming at +R28,00 growing and reaching R58,50 and Iscor at R6,00 growing and reaching R26,00 resulting in a gain of about R60,00 per share.

The shareholder activism preceding unbundling, though significantly reduced, will put pressure on management to perform to the expectations of the market. While it is important that management has insights in terms of how markets perceive companies, management needs to look at long-term sustainability of the company in their planning and actions. The King II report on corporate governance classifies shareholders as moving targets – they have conflicting interests and they come and go. The report tasks management to act in the best interests of the company and all its stakeholders, and not to act in the interests of shareholders only.
In the aftermath of Enron and WorldCom attention should shift from satisfying the markets [analysts] to the cause and effects of financial performance. Management should move away from managing market expectations and invest more time in building analysts' understanding of the company and its fundamental economies. This means being much clearer about the company's strategy, what risks it entails and what the analysts need to believe about the company and its markets in order to promote the company as a good investment proposition. The strategic proposals outlined here have been made with the above in mind.

4.2 DIVESTITURE PROPOSAL

The portfolio that Kumba ended up with was by default and not by design. No focused strategy was arrived at except pulling together all that was mining and hiving it off and unbundling from Iscor, irrespective of a strategic fit or not. Most of the commodities made a perfect fit in an integrated Iscor, as it needed iron ore as feedstock for its steel mills, coal for the furnaces, zinc for metal sheeting and dolomite for the furnaces. The commodities did not promote Kumba as being a focused mining company. Arguably all business units and therefore commodities contributed to the profitability of the company and they themselves were profitable.

The strategic objective of focusing on commodities and investments that offer above-average growth and returns while spreading the risks associated with the volatility that characterises the supply and demand for minerals and metals in the world's major markets, as articulated in the 2002 annual report, should be put into effect. Our analysis gleaned from company documents and research conducted by various analysts has identified three performing commodities that can provide growth going forward.
The significant exposure in iron and the performance of the commodity has ensured phenomenal success for the company post unbundling. Iron ore contributed 73 percent of profits. This has tempted analysts and investors to push the company to divest in other commodities and become a pure iron ore play and not allow the less performing business units to dilute the earning capacity of iron ore. This has merit, as it would allow for the company to afford the project pipeline in iron ore including Sishen South and the Hope Downs projects. A focused approach would ensure that management time is not diverted and projects like the consolidation of the Northern Cape would materialise, as the company would have the balance sheet and the resolve to make it happen. The iron ore export channel could be expanded by working towards concessioning of the railway line and the port to raise funds for such expansion. This would take the capacity to 50 million tonnes per annum of export and together with the 25 million tonnes coming from implementation of Hope Downs make Kumba to be a serious player in the iron ore business. The market is ready to take additional output, as they need an alternative from an independent player outside the big three of CVRD, BHPBilliton and Rio Tinto. Figure 13 shows the current situation and possible situation of the iron ore situation, taking the above into consideration.
Table 4.1 shows the dilution caused by the poorer performing business units to the iron business unit. This strengthens the argument for Kumba to be a pure iron ore play.

Table 4.1
Profit contributions of the various units

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Kumba Resources</th>
<th>Iron ore</th>
<th>Heavy Minerals</th>
<th>Coal</th>
<th>Base Metals</th>
<th>Industrial Minerals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin (%)</td>
<td>2</td>
<td>28</td>
<td>24</td>
<td>17</td>
<td>11</td>
<td>26</td>
</tr>
<tr>
<td>EPS (cents)</td>
<td>385</td>
<td>428</td>
<td>02</td>
<td>09</td>
<td>04</td>
<td>01</td>
</tr>
<tr>
<td>% No. of Employees</td>
<td>100</td>
<td>43</td>
<td>4</td>
<td>30</td>
<td>12</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Kumba records [figures balanced by staff from corporate centre]

The impact of the dilution of Kumba's income earning capacity by not being a pure iron ore play of 428c to 385c because of the less performing commodities, is clearly evident from the table above. While margins give a somewhat comforting picture the earnings per share and the disproportional employee numbers relative to earning capacity strengthens the argument.

However one need to recognise that iron ore is towards the top of the commodity cycle and may take a downward scale. The fall in prices [2.5% for fine ore and 5% for lump ore] in April and the overcapacity that has been experienced by the steel manufacturers are not good signs for the iron ore producers at this stage.

A significant slump in iron ore prices can close down Kumba if it were to be a pure iron ore play. It is reflective that Kumba chose a balanced portfolio growth situation instead of 'grow or bust' situation.

The investment in heavy minerals is evaluated with that set of circumstances in mind as their prices are picking up and the current overcapacity is expected to over by 2006 when furnaces will be in full production. Supply contracts signed for 60% of output are effective from 2006 [Kumba website].
4.2.2 Heavy Minerals

Figure 4.3 shows the correlation between industry consolidation and returns. It is evident that highly concentrated industries enjoy superior returns over those industries that are less concentrated. What is also noticeable is that commodities that enjoy superior returns are those that are not traded on the spot market like the London Metals Exchange (LME) but negotiated and priced on a long-term contract basis. Iron ore as shown on the graph attracts the highest returns. Titanium dioxide is also placed in the top right quadrant indicating its concentration on capital employed and attractiveness. Heavy minerals is a major growth area for Kumba.

With both furnaces at full production by 2005, the project will have the capacity to produce 250,000 tonnes of titanium slag and substantial quantities of zircon, rutile and pig iron. Combined with Ticor Ltd in which Kumba already has 49.2 percent, it will rank as the world’s third biggest producer of heavy minerals feedstock. The current low earning per share ratio of nine cents must be looked at against the background that Ticor is not consolidated into the books of Kumba and that we are only using the Empangeni project figures. Heavy minerals have very high margins and expected margins once fully ramped up are about 35 percent [Kumba records].

4.2.3 Coal

Coal is situated at the top right of the bottom left quadrant and under normal circumstances it requires serious attention and possible divestiture decision. However, the strong annuity income provided by the business unit through long-term contracts with Eskom and Iscor mitigates against the positioning and makes it a cash cow for funding of other projects. Operating margins of 17 percent are not insignificant, considering that one of its mines is operated as a captive mine for Iscor. The growth prospect in terms of participation in the Phase V development in Richards Bay, entitling Kumba to two million tonnes per annum of export access, synchronised with the development of the Kalbasfontein Colliery, are attractive propositions for the business unit. The possibility of merging Kumba Coal with Eyesizwe Coal [a black economic empowerment company] presents exciting opportunities for growth. When implemented, this unit will be the third biggest supplier of coal [35 million tonnes per annum] to the domestic market [Kumba records].
4.2.4 Base Metals
Zinc prices have been depressed for a long time and there is no prospect of them recovering soon. Low positioning in the quadrant and negligible contribution to the bottom line of the company makes Base Metal business unit a candidate for divestiture. Care should be taken, however, as exit costs might be inhibitive.

4.2.5 Industrial Minerals
While the industrial minerals business unit continues to make profits, it is too small to provide any significant growth. Coupled with its disproportional pull on human capital and the fact that it has no strategic fit to the business make it a candidate for divestiture.

4.2.6 AST
Kumba has no reason to be in information technology and the exit plan started by hiving out information technology to form AST should be finalised by formally divesting from the company. The AST share price has been on a downward slide for the past year and there are no prospects of recovery particularly considering that the sector is taking a pounding.

4.3 MERGERS AND ACQUISITIONS PROPOSAL
Mining extracts depletable resources and in the long term if you do not grow you die. Mergers and acquisitions have been identified as major areas of growth and are explored hereunder.

4.3.1 Heavy mineral strategy
The decision to identify heavy minerals as an avenue for growth is proving to be a sound one. Prospects with the signing of long-term supply of 180 000 [Dupont & Millennium] tonnes of product which is more than 60 percent of production even before the commissioning of the first furnace proves confidence of the market in the capacity of the company to deliver. However, for Kumba to enjoy full value of its exposure to heavy minerals will have to take a decision relating to taking off minorities at Ticor Ltd. Size does count in the mining industry and a strategy of “eat or be eaten” has long been the driving force of consolidation. Bulking up to be able to afford acquisitions will have to be on the top of the minds of Kumba executives. Heavy mineral industry is in the process of consolidation and is the ideal time to make acquisitions. Kumba's share price has been doing well and it would make sense to do a share swap for some of the deals to get full exposure and control of cash flows.
4.3.2 Northern Cape iron ore consolidation

There is no doubt about the enormous synergies that would result from the rationalisation of the Northern Cape iron ore operations. Figures of about R600 million have been estimated.

Any proposal on the consolidation should bear the following in mind in order to fully capture existing synergies.

- Supplying all inland domestic markets from Beeshoek in the South. Sishen South reserves could be mined as a natural expansion of Beeshoek, achieving cost efficiencies in development costs and initial overburden removal.

- Supplying the export market from Sishen North would immediately reduce costs of the 70 kilometre railage of 4,5 million tonnes per annum from Sishen South to Saldanha Bay via Sishen. Rationalisation of operations and using one management would facilitate scheduling and increase throughput. Bruce reserves adjacent to the Sishen mine would be developed as a normal expansion programme to save on overburden removal.

- Rationalisation of the wagon fleet [Assmang uses 80 cubic metre wagons whilst Kumba uses 100 cubic metre wagons] would increase capacity and efficiencies.

- Consolidation of the iron channel [Orex and Saldanha Bay port operations] into one operation allowing for better management and reinvestment decisions. Concessioning of the railway line would lead to access to finance for maintenance and expansion. Kumba Resources, as the 80 percent user of the line, needs to prepare concrete proposals for such a move.

- Explore the use of Coega harbour that is currently being developed in Port Elizabeth. There is a railway line from Sishen to Port Elizabeth. This would increase the export tonnage to about 80 million tonnes per annum.
4.4 CONCLUSIONS

The de-merger from Iscor realised significant shareholder value and made sure that both companies are focused. They both posted good results at the end of the financial year [June 2002].

Kumba has a strong balance sheet, having reduced the debt inherited on unbundling from R2,5 billion to R1,1 billion at the end of the last financial year.

The strategic objective of focusing on commodities and investments that offer above-average growth and returns while spreading the risks associated with the volatility that characterises the supply and demand for minerals and metals in the world's major markets, as articulated in the 2002 annual report, should be put into effect.

Size does count in the mining industry. Bulking up to be able to afford acquisitions will have to be on the top of the minds of Kumba executives. Heavy mineral industry is in the process of consolidation and is the ideal time to make acquisitions.

Kumba will have to divest from non-core businesses like AST and the smaller operations like zinc and industrial minerals to build enough capacity to tackle bigger projects.
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