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**KUMBA IRON
ORE
FINAL RESULTS**



2021 | By Lesego Mthombothi

KUMBA IRON ORE reports record earnings and declares a strong dividend.

Kumba delivered a solid set of final results for the full year ended 31 December 2020 on the 23rd of February 2021, which reflected a robust recovery in Chinese steel production following disruptions to the global economy due to the COVID-19 pandemic.

- Revenue increased by 25%, benefitting from higher realised prices,
- Earnings before interest, tax, depreciation, and amortisation (EBITDA) increased to 57%,
- Free cash flow generation increased by 21% to R20.7 billion,
- Achieved return on capital employed (ROCE) of 109%,
- Headline earnings per share (HEPS) up almost 40% to 7 107 cents,
- A final cash dividend of 4 130 cents per share was declared (total dividend per share (DPS) for the year of 6 090 cents)

Revenue and earnings before interest, tax, depreciation, and amortisation (EBITDA) for FY 2020 were substantially higher at R80.1 billion and 57% respectively than the R64-billion and the 52% for the comparable period in FY2019, mainly as a result of a 14% decline in dollar/rand exchange rate, 40% higher iron ore prices and cost savings of R1.3 billion. Sales were partially offset by a decline in sales volumes to 39.7 million tonnes from 42 million tonnes in the prior comparable period due to COVID-19 related disruptions and bad weather conditions, however, average realised iron ore export prices increased 18% to USD115 per tonnes, up from USD97 per tonne.

Pretax profit for FY2020 rose 41% to ZAR41.20 billion from ZAR29.25 billion in the prior year.

Production fell 13% to 37.0 million tonnes from 42.4 million tonnes, reflecting the impact of operational and logistical COVID-19 related disruptions to their mines in Sishen and Kolomela in the Northern Cape and their Saldanha Port.



Source: Koyfin

Kumba's strong net cash generation resulted in R20.7 billion of free cash flow (up by 21%) giving the company ample room to almost triple its final dividend from 1 573 cents per share in FY2019 to 4 130 cents (includes a top-up dividend of 800 cents per share). Kumba's full-year dividend of 6 090 cents per share is almost double the 3 024 cents paid in FY2019.

Production guidance is set for between 40 million tonnes and 41 million tonnes, with sales also set to be between 40 million tonnes and 41 million tonnes for FY2021.



Kumba is a strong and stable business that has consistently added value to its shareholders over the years. Global iron ore supply is expected to exceed demand within the next five years, leading to a natural decline in iron ore prices, which will negatively impact margins and lower returns. This potentiality would affect every company within the industry and in our opinion, Kumba presents a competitive advantage because of its stable financial position with little to no debt and high margins from its ability to keep costs low. Kumba is also investing in assets that we think will soon be the envy of its competitors, it's R3.6 billion planned investment in extending the life of its Sishen mine by two decades will strengthen its capacity to produce high-quality iron ore and benefit from the "lump premium".

Upside risks

- **Another commodity supercycle?** - Iron ore is one of the world's most in-demand commodities as governments globally implement stimulus spending following pandemic lockdowns which will drive demand for raw materials across the board.
- **A weaker Rand** - Iron ore is priced in dollar terms globally and Kumba is considered a rand-hedge share because it produces its goods in Rands and exports them in dollars.
- **Global seaborne iron-ore supply** - Vale is experiencing the lingering after-effects following the devastating dam collapse which happened two years ago, and legal and pandemic related difficulties,
- **Decarbonisation** - to reduce carbon emissions globally high-grade iron ore is expected to substitute low-grade iron ore. Two-thirds of Kumba's iron-ore sales already constitute lumpy high-value iron ore which fetches higher prices than its larger peers (realised \$115/tonne vs \$99/tonne realised by Vale and Rio Tinto based in Brazil and Australia respectively).

Downside risks

- **A slowdown in Chinese demand for commodities** - There are risks that stock levels in China will stop being built up or be run down in the medium term,
- **A stronger Rand** - Iron ore is priced in dollar terms globally. A stronger Rand can negatively impact revenues and margins.
- **Capex cycle** - Kumba announced a R7 billion investment in Kapstevl South project at its Kolomela mine and a R3.6 billion investment in extending the life of its Sishen mine which reflects the company's positive outlook. However at such elevated iron ore prices which are expected to decline in the medium to long term, weaker iron ore demand and falling prices could threaten its strong balance sheet and strong cash flow generation.

Valuation

Kumba's valuation is not demanding from both a price-to-earnings and dividend-yield perspective. Kumba's P/E of 9.03x is not overstretched in our view (industry average P/E of 11.64x) and it offers great value with a dividend yield of 9.55% (industry average D/Y of 6%). We performed a sensitivity analysis on the share price and conclude that if earnings were to decline or increase by 10% in FY2021, the share price could range between R511 and R938 representing a downside and upside of 21% and 46% respectively.

Kumba Iron Ore is Africa's largest iron ore producer and is also a member of the Anglo American Group which holds a majority stake (71%).

Five-Year Key Financial Metrics

	FY16	FY17	FY18	FY19	FY20
Revenue	R40,2bn	R46,4bn	R45,7bn	R64,3bn	R80,1bn
EBITDA Margin	43.7%	42.4%	45.1%	51.6%	56.9%
EBIT Margin	36.0%	37.8%	35.8%	44.7%	50.9%
Net Income Margin	21.5%	26.6%	21.0%	25.3%	28.4%
ROCE	28.7%	31.1%	28.6%	48.0%	54.5%

Source: Company Financial Statement

Stock Information

Sector	Mining
Price (26/02/21)	R649
52-week range	R205.25-R687.21
Market Cap	R205.83 bn
Enterprise Value	R198.8 bn
Shares Outstanding	322 085 974
Free Float	64%
1m Price Return	1.13%
3m Price Return	24.95%
6m Price Return	16.09%
Total Return (1-yr)	113.13%
Return YTD	3.08%
HEPS	7 107 c
Growth	40%
Dividend Per Share	6 090 c
Growth	30%
P/E	9.03x
Forward P/E	8.75x
Dividend Yield	9.35%
Beta (2-year)	0.74
Financial year-end	31 Dec

Source: Bloomberg, Koyfin and Company Financial Statements

Earnings Growth

	-10%	-5%	0%	5%	10%
8x	511	540	568	597	625
9x	575	607	639	671	703
10x	639	675	710	746	781
11x	703	742	781	820	859
12x	767	810	852	895	938

Source: ThinkMarkets Analysis

