

European Equity Research

J.P. Morgan Securities Ltd.
Johannesburg, July 15, 2003

Implats - Zimplats revisited

Strategic review, earnings update and recommendation upgrade

Overweight

Previous: Neutral
49,000c

Year End - Jun	2002	2003E	2004E	2005E
Adj EPS (c)	6,829.02	4,969.73	4,732.40	5,949.05
P/E	7.2	9.9	10.4	8.2

Resources - South Africa

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We have revised our R/\$ forecasts and updated our forecast EPS for Implats. We have finalised our estimates for FY 2003, and highlight our views on the Zimbabwe operations, which we recently visited.

- An operational and price review has led us to upgrade our FY 2003 EPS estimate to 4970c (4510c) - results are due on August 28. A firmer R/\$ forecast offset by a higher Pt price outlook have resulted in minor adjustments to our subsequent EPS forecasts.
- A recent visit to Implats' Zimbabwean assets suggests to us that the group's future strategic options are greatly enhanced following its gain of control over Zimplats. We foresee that greater flexibility could generate significant shareholder value.
- Zimplats brings with it strong long-term growth possibilities, which could allow further value to be released through the disposal of strategic assets, which we believe are no longer needed to maintain critical mass.
- Zimbabwe complicates long-term valuation. But we believe there is substantial upside risk to our basic DCF value of R523/share. Short-term valuation metrics appear very attractive relative to Implats' peer group.
- We are upgrading our rating on Implats from Neutral to Overweight relative to the SA resources universe we cover. The group's 100% free-float post Gencor's unbundling further underpins this change.

Company Data

52-Wk Hi/Lo	65,001-34,600c
Mkt.Cap (\$bn)	4.3
Mkt.Cap (R bn)	32.9
Total No. of Shares (mm)	67.2
RIC	IMPJ.J
BB	IMPAY

Zimbabwe could transform Implats' strategy

Introduction

Following a two-day visit to Mimosa and Zimplats' operations, we are increasingly comfortable that Implats' strategy can be transformed to the benefit of shareholders as a level of flexibility is introduced that was previously impossible.

Implats already controls 51% of Zimplats, the A\$4.08 offer to minorities should serve to increase the level of control and, taking account of localisation (Zimbabwe's version of BEE), we envisage Implats could ultimately control 85% of the assets, depending on minorities' take-up.

Currently Zimplats is producing at a rate of just under 100,000oz Pt pa, and bearing in mind the 165 million platinum ounce resource and the geometry of the orebody, we believe Zimplats' potential output to be in excess of 2 million ounces Pt pa in the long term (25 years or so). Such a large-scale operation could, we believe, be positioned well into the bottom half of the industry cost curve.

At Mimosa, to the South of Zimplats, Implats and Aquarius jointly own and control operations (50/50 JV), which by our assessment could be doubled in size over the next five to ten years to produce between 150,000 and 200,000oz Pt pa. And because of unusually high base metals grades, we expect Mimosa to become established as one of the world's lowest-cost sources of PGMs

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Implats' Zimbabwe assets are world class

What both of Implats' Zimbabwean investments have in common is their shallow nature. Moreover, the orebodies are both suitable for low-cost mechanised underground mining (as well as open pit mining).

In addition, because of the shallow nature of the orebodies, their geometry and proximity to infrastructure, the capital expenditure required to create production capacity is low relative to maintaining the current 1 million ounce Pt production capacity at the group's mature and deep operations in Rustenburg.

Furthermore, at between 20 & 25%, and with no royalties payable at the moment, the tax regime is more friendly.

Assuming the political problems in Zimbabwe are resolved over time, we believe it would be logical for Implats to shift its production focus away from Rustenburg towards Zimbabwe – our current modeling indicates that returns for shareholders would be superior. Lower capex, similar or lower costs, low project lead times and less labour intensity – as well as a less onerous fiscal regime – all underpin this assertion.

Positive operational data and site observations

Ahead of our site visit, we had concerns that underground mining in the Hartley Complex may bring with it major ore dilution due to difficult hangingwall (roof) conditions. We were concerned that rock falls would dilute the head grade, increase costs and present an unacceptable safety issue. A careful examination of conditions in the extensive trial mine that has been excavated over the past nine months, clearly indicated to us that the conditions are manageable.

At 3.25g/t, the plant delivery grade is in line with plan – and safety is acceptable and should, in our view, remain so. The choice of mechanised drilling and support systems means that risk of dilution and injury due to falls of ground is minimised.

We expect Implats to conduct a thorough internal and independent analysis of all data pertaining to Zimplats' assets, now that it has control. Following this, we anticipate that a definitive growth strategy for the assets will be announced. And because of the relatively attractive economics associated with Hartley compared to Rustenburg, we would not be surprised if management opts for a more aggressive growth profile than that articulated thus far by Zimplats (assuming of course that no political bombshells materialise).

Zimbabwe: Valuation implications

In our view, Zimplats complicates the long-term (DCF) valuation for Implats because so many more permutations of production strategy are now possible. But our model clearly shows that Zimplats alone has the potential to create material additional value for shareholders. **Looking at Zimplats in isolation**, and applying Implats' WACC (which we calculate to be 7.8% real), we calculate that just the basic (existing), Makwiro open pit operation (c100koz Pt pa) is worth R16.07 per Implats share, assuming existing ownership. **On a stand-alone basis, expansion of operations to a level of 550koz Pt pa by 2014, indicates a value of R35.53 per share on our calculations, assuming 51% ownership. At 85% ownership, this increases to R59.22. And by our assessment, at 550koz Pt pa, we believe only a quarter of the orebody's productive potential would be utilised.**

Moreover, in this simple analysis we have not attempted to adjust our cost assumptions for economies of scale, which could add further value. And value builds rapidly with time, because our expansion model is front-end loaded with capex – and the projects we envisage all have lives well in excess of 25 years. In the first five years of our expansion model, the majority of free cash flow is reinvested. In money of today, based on our assumptions, which we detail later, free cash flow for our expansion case is negative in FY 2005E (-R98m), positive in FY 2006E (R84m) and peaks only in FY 2014E at R1.05bn, where we estimate that it would stabilise for a further 10-15 years.

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A reduced production and future (heavy) replacement capex profile at Impala Platinum in Rustenburg (which pays 30% tax, 12.5% STC, the Bafokeng royalty and soon a state royalty) could add further value. As could, we believe, the disposal of some of the group's strategic assets.

Our latest, basic Implats model shows a DCF value of some R523 per share, assuming 85% ownership of Zimplats with expansion to only 190,000oz Pt pa (in other words, including the existing open pit operation and production from the trial mine that we have visited) or some 7% higher than the current share price – which is not all that exciting. But because of the long-term valuation complexity, which to us implies upside, we are tempted to focus more on short-term measures. And here our model shows that Implats offers prospective dividend yields of 5.1% and 6.4% for the years to June 2004E and 2005E – which is somewhat more exciting.

Conclusion

Our modeling demonstrates that Implats' **Zimbabwean assets compete economically with its SA assets in terms of operating economics.** We foresee a steady-state cash operating margin of around 42% from the Zimplats – 54% from Mimosa, which compares to an overall group margin that we estimate of around 35%. And overall, the Zimbabwean capacity options appear more competitive in terms of capex – compared to Impala Platinum Mines in Rustenburg, the operating depth is shallow. In terms of the group's existing plans, Impala's Rustenburg operations in 10 years' time would be located at depths between 1,000m and 1,700m. The Zimbabwean operations on the other hand, will probably be positioned between surface and 400m, at the most – as they could be for the next 30 years.

The group's investments in Zimbabwe will, in our opinion, introduce to Implats a level of operating **flexibility** that previously was absent. And this has the potential to further add substantial value for shareholders. Part of this value, we reason, may be released by the disposal of **strategic assets**, which in our view, **are no longer as crucial to Implats.** We don't think the group needs to hold minority interests to maintain critical mass any longer.

Valuation is complicated by the group's acquisitions in Zimbabwe, with the risk to our R523 DCF value, clearly to the upside. According to our calculations, short-term metrics show us that Implats offers significantly superior value compared to its principal peers, AngloPlat and Lonmin.

We see room for upward rerating relative to these miners whose shares, in our view, have factored in much of their growth potential. Implats' shares have not, in our opinion.

Revised forecasts

The Rand

Forecasting the South African rand

We have adopted a two-phased approach to forecasting the South African R/US\$ exchange rate. In the long term we expect the rand to average around our estimated PPP line, consistent with 30 years of history as shown in the chart below, while in the short term we expect other dynamics to dominate.

PPP Methodology

Our PPP methodology is based on the differential between the non-seasonally adjusted (nsa) US finished goods PPI (Source: Bureau of Labor Statistics) and the South African total PPI (Source: StatsSA) monthly time series since September 1973. We have then adjusted the resulting PPP line by minimising the mean squared error between the PPP line and the month-end R:US\$ exchange rate. We have used the financial rand when it existed and otherwise the commercial rand.

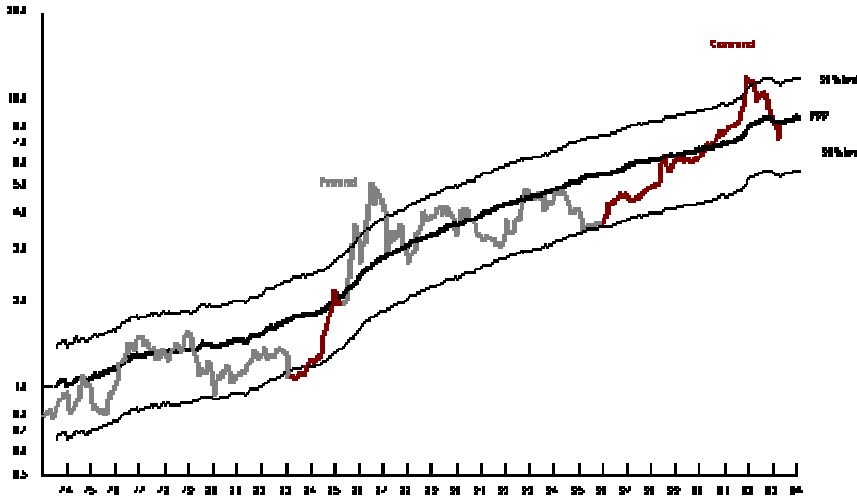
The forecast PPP line to December 2004 is generated using JPMorgan's forecasts for US finished goods PPI (seasonally adjusted (sa) with year-on-year changes applied to the nsa time series) and for South African finished goods (nsa). In the longer term we have extended the PPP line assuming aggregate US PPI of 2% and aggregate South African PPI of 5.5% - lower than our previous framework of 2.5% and 8%.

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Chart 1: Purchasing power parity trend for the rand versus the US dollar (R/US\$)



Source: Bureau of Labor Statistics, StatsSA, JPMorgan, JPMorgan estimates

Short-term view: Currency fundamentals to deteriorate in 03H2

The rand has been a strong performer in 03H1, appreciating by 12.5% against the dollar, after rising a massive 40% against the dollar in 2002, but we believe that it will weaken in 03H2 to around R8.60/\$ as economic fundamentals start deteriorating, as discussed below.

The rand has been supported in 03H1 by the move into high-yielding currencies (like the Australian dollar). With the global easing cycle now largely over (outside of the Euro area), the SA monetary easing cycle only just commencing with another 300bps of short rate cuts expected, in our view investors are likely to switch attention towards asset classes with more potential for capital growth, ie equities. Hence, closing interest rate differentials in 03H2 should at some point start weighing against the rand exchange rate.

Exchange control relaxation measures for domestic fund managers, which were announced in the February 2003 budget, have eventually been finalised in terms of the administration process and the first flows are set to occur from 1 August 2003. We estimate outflows of some R11 billion to take SA's large fund managers up to the 15% offshore investment limit that can now be freely achieved without asset swap constraints. Furthermore, the large blocked rand flows will probably also start occurring only in 03H2 with the SARB to date having only allowed blocked rand outflows of less than R5 million per transaction. The National Treasury estimates the size of the blocked rand pool at some R10 billion -R15 billion. We do recognise that some of these outflows could be partly offset by inflows via the amnesty measure, but forecasts of the potential size of these inflows are largely impossible. We do expect, however, that the size of the outflows will dwarf the likely inflows from the amnesty.

The FDI flows needed for enduring currency strength are still lacking, and with SA's competitive advantage being widely perceived to be resource-sector dominated, potential inflows will probably be largely driven by a competitive exchange rate as well as structural labour market adjustments, which are not yet evident.

We expect the current account deficit to widen in 03H2. The current account shifted into deficit in 03Q1 at 0.6% of GDP, after posting a healthy surplus in 2002 of 0.3% of GDP on the back of the weak rand benefits of 2001. With domestic demand still very robust in SA and GDE growth of

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3.7%q/q, saar in 03Q1, we expect import momentum to remain strong, while the strong rand exchange rate is likely to take its toll on exports. Short rate easing by the SARB is likely to continue to support healthy domestic demand and hence underpin buoyant import growth in 03H2. This is likely to weigh heavily on South Africa's trade performance in 03H2 in particular, until the global demand recovery supports a recovery in SA export growth. We expect our improved global growth outlook to work through only with a lag to improved SA export momentum in 2004. Hence, trade account deterioration is likely to be felt most severely in 03H2.

Our new rand forecast

Overall, in 03H2 we expect both capital and current account deterioration to set in. Thus we forecast the R/\$ exchange rate to weaken to R8.60/\$ by year-end 2003 and R9.00/\$ by year-end 2004. Thereafter our current best estimate is a return to the PPP line at R9.15/\$ by year-end 2005 and then to average the PPP line into the future.

A caveat to our weaker rand view is a major dollar sell-off, which could support a stronger rand exchange rate for longer than expected, despite the unfolding rand economic fundamentals detailed above.

Table 1: R/US\$ end-of-period forecast

Period end	PPP	New Forecast	Previous Forecast
September 2003	8.45	7.80	8.00
December 2003	8.57	8.60	8.75
December 2004	8.84	9.00	10.00
December 2005	9.15	9.15	10.59

Source: JPMorgan estimates

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Forecast EPS and DPS

Table 2: Forecast income statement and balance sheet

R millions, year-end June 30		2003E	2004E	2005E
Prices				
Platinum	(\$/oz)	609	639	606
	previous	609	614	571
Palladium	(\$/oz)	256	188	208
	previous	254	194	269
Income statement				
Net turnover		12,404	12,595	16,420
Net cash costs		6,974	7,709	10,448
EBITDA		5,429	4,886	5,971
Depreciation		370	476	587
Royalty		579	471	484
EBIT		4,481	3,938	4,899
Net financial/other income		(52)	307	455
Associates' pre-tax income		783	592	566
EBT		5,212	4,837	5,920
Taxation		1,772	1,548	1,776
Minorities		98	107	144
Earnings		3,342	3,182	4,000
EPS (c)		4970	4732	5949
Dividends		1,759	1,675	2,105
DPS (c)		2616	2491	3131
Balance sheet				
Shareholders' funds		10,867	12,374	14,269
Long-term debt		150	150	150
Other liabilities		5,630	5,717	5,747
Total funds		16,647	18,241	20,166
Fixed assets		10,204	11,318	12,603
Current assets less cash		2,395	2,432	3,170
Cash		4,048	4,491	4,393
Total assets		16,647	18,241	20,166

Source: JPMorgan estimates

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IMPALA PLATINUM/ 49000c/Overweight

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