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Address to Wits Business School

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**National and Corporate Imperatives for Benefiting from the
Commodity Super-Cycle**

Slide 1: Cover Slide

Ladies and Gentlemen, Honoured Guests

I am delighted to address you today at Wits Business School and wish to thank Professor Ncube for his kind invitation. There are many things which I do not know – and I think that this will become apparent during this lecture - but I am sure of this that I do not at all fill the shoes of those who have given this lecture in previous years and I am therefore greatly honoured to be talking to you this evening. I, of course, know Wits quite well; having lectured in the Faculty of Commerce for almost 10 years in the

1980s and thereafter acted as an external examiner for some years. I am delighted that our company Xstrata has entered into a long-term relationship to support the University of Witwatersrand through a public-private partnership to construct the fourth quadrant of its Chamber of Mines building. So while this is not quite my alma mater, my academic roots certainly have a Wits connection.

In the last eighteen months we have seen some astonishing events in the global economy, during what is without doubt a fascinating period in economic history. Of course, 'fascinating' is not necessarily the first word that springs to mind while the world's financial markets are seizing up, enormous uncertainty prevails and in my case one's company's share price collapses dramatically in the space of a few weeks! But however traumatic the past year and a half may have been for companies, governments and citizens in many different countries, the financial crisis and ensuing global recession have had a lasting impact on the shape of our world, in ways which are only just becoming clear. I'd like to share some of my experiences of that period, as well as talk about the ongoing factors which will continue to bear an influence on global commodities and the mining sector for a number of years to come – a sector of obvious great importance to South Africa.

Many of you will be familiar with the so-called commodities 'super-cycle' or the often-cited belief that commodity prices would be 'stronger for longer' which prevailed from late 2003 up to the impact of the financial crisis on mainstream economies in 2008. And perhaps just as many of you might well have looked at tumbling commodity prices in late 2008 and early 2009 and concluded that the super-cycle was surely dead – fallen in battle during the financial crisis and subsequent recession, subdued demand from the West and a decimated export industry in China.

The title of my address perhaps gives you a clue that that I have a quite different perspective and I'll talk in more detail later about why I continue to believe that the factors that gave rise to the initial commodities boom remain very much in force, slowed only temporarily by the financial crisis.

While the commodity sector is clearly vitally important for the future of Xstrata as a business and the mining industry as a whole, it also has far broader implications for the social and economic development of much of the world, particularly for resource-rich nations such as South Africa. So I also propose to spend some time using our experiences as a major investor in commodities, globally and in South Africa, to discuss the factors that are essential to enable countries such as South Africa to benefit from a commodities boom. And finally, I'll briefly outline

the attributes that are, in my view, necessary for companies such as Xstrata to prosper in this environment.

But first, let's turn to our experiences of the past year and a half and look at the likely implications for the commodities sector. Looking back to early 2008, the world was in a generally optimistic frame of mind. Economies were growing, in particular those of China, India, Brazil and other industrialising nations, with the Western economies kept afloat by prodigious consumer and private sector spending, fuelled by a plentiful supply of cheap debt.

Just a few months later, a slew of troubled investment and lending banks had been absorbed by others, often at the behest of Government, and then a major investment bank on Wall Street, Lehman, collapsed. Financial markets seized up and the world experienced the steepest drop in economic activity since the Great Depression. In the commodity markets, we saw a sudden and severe destocking by producers and customers, with some commodity prices tumbling by up to 70% in the space of a few weeks.

I think it's fair to say that while there were warning signs of a decline in growth in the OECD and even portents of a mild

recession, none of us anticipated that the global economy would suffer such a catastrophic stroke, deprived of the very oxygen that fuelled it – freely available cash. Indeed, just a few months before the collapse of Lehman Bros, Xstrata's coking coal customers had agreed record contract prices. Similar deals were struck for iron ore, ferrochrome and other commodities and ships were queuing at ports waiting to load commodities that the mining industry and logistics infrastructure simply couldn't supply quickly enough to satisfy demand. All of this indicated that our customers in Asia and elsewhere were also expecting a continuation of tight market conditions and strong demand for some time to come. A matter of weeks or even days later, the situation had sharply reversed and demand almost completely collapsed.

The crash was precipitated by what initially seemed at the end of 2007 like the normal and periodic slowing of the business cycle, which led to a decline in US house prices. Housing foreclosures had already doubled to 1.3 million in the US by the end of 2007. This would all have been digestible had it not been for the sheer volume of high-risk mortgages that had been issued in the run up to this economic slowdown. As an aside I reflect that the sub prime saga reflects what has been called the unacceptable side of capitalism, and this is true, but it also reflects the devastating

consequences of political intervention in the system regulating supply and demand of debt and its risk. A large measure of sub prime lending arose out of political intervention in the United States seeking as a goal the expansion of home ownership in the electorate. Sub prime lending resulted as mortgages were provided to those who were not able to meet the mortgage obligations. Banks compelled into this business covered their risk of repossession and resale into a housing market short of stock thereby realising prices above the mortgage. At that time the only casualty was the poor sub prime purchaser. These now infamous sub-prime mortgages were packaged into bundles of securities which collectively appeared to represent acceptable risk to the financial institutions around the world which bought them, seeking to increase their returns by taking on the combination of seemingly low risk and high return these packages represented. Compounding the problem, structured Investment Vehicles were created by many banks – and sponsored by the very same institutions - to take these investments off balance sheet and, second, insurance against default of these securities was sold by companies such as AIG. This all made the securitisation of what were inherently high-risk bundles of mortgages seem innocuous and a safe bet. When homeowners began to default on their mortgages and property values fell below the value of the

mortgage as the stock of houses exceeded supply, the whole system collapsed like a pack of cards, putting hundreds of financial institutions at risk and, importantly, leading to over time a complete freezing up of the banking system. So by 2008 we were all casualties! Enter Lehman Brothers which collapsed in September 2008, the spread of LIBOR over the three-month US Treasury Bill had grown by 300% to almost 4%, and the acute problem of the banks' reluctance to lend to each other and, by definition, to their customers. The system teetered on the edge of the abyss for some considerable time.

Slide 2: Global economy effectively suffered a stroke

The cost of taking out insurance against debt default – know as Credit Default Swaps or CDSs – ballooned overnight. For example, CDS rates for double B rated debt increased from 100 basis points in 2007 to almost 1,100 basis points in late 2008, making it prohibitively expensive to insure against almost any type of debt issuance. We know now that governments acted in relative concert to re-inject liquidity into the global economy, with some success. However, even today, some 18 months after the

depths of the credit crunch, liquidity remains constrained to all but the highest quality borrowers.

Without the very lifeblood that enables industry to function – let alone to grow – the slowdown in industrial production and consumer spending was inevitable and marked. The deepest recession since the 1930s reached its nadir in March of 2009.

From my viewpoint as the CEO of Xstrata, these events were deeply troubling, to say the least. Like most major mining companies we had entered into a sudden and severe recession with a level of debt that, while relatively comfortable in more buoyant times, was clearly higher than one would want in difficult economic times. In fact, the combination of an expectation of continued record levels of demand and freely available low-cost debt resulted in the mining industry as a whole entering the downturn with record high levels of debt – around \$180bn in total, compared to a historical average of around \$30bn. Mining share prices came under extreme pressure – falling by up to 80% almost overnight, as customers preferred to deplete available stocks, rather than purchase new raw materials.

I think, as an important aside, that it is instructive to share with you Xstrata's response. There are two ways in which an organisation can respond to a crisis of this type and magnitude:

- Cut costs indiscriminately and batten down the hatches in the hope that the storm will wash over; or
- See the downturn as an opportunity to substantially and sustainably improve the relative long-term competitive position of the organisation, preparing it to benefit differentially in the upturn.

We chose the latter, but we executed it in a unique way. We resisted the temptation to roll out a plan devised at Head Office. Rather we asked our businesses to take every action they could to prepare us for what was looking like a prolonged recession; we didn't specify what was required. We simply set out Xstrata's situation, our view of the extent and nature of the crisis and the requirement to conserve cash and take action, without impairing our future prospects for growth and without impacting on safety or environmental performance. In response, our commodity businesses implemented a broad range of initiatives very quickly. While many of these initiatives were also being put in place by other companies – for example cutting back capital expenditure where we could do so safely, or reducing operating costs – our

businesses took a longer term, strategic view. Crisis gives one licence to act from one's stakeholders in ways not normally indulged. So they took the opportunity afforded by this massive discontinuity to do major surgery to our asset base and to accelerate the plans we had to transform the cost profile of our businesses. This is particularly apparent in our nickel and zinc businesses, where we have reduced the costs of both businesses by around 50%, from being amongst the higher cost industry producers down to sustainably low cost positions, making them very robust businesses for the future.

In the face of a period of macroeconomic uncertainty, I also took the decision to recapitalise the balance sheet through a major rights issue as rapidly as possible in early 2009, when equity markets were all but closed for business. This was not an act of desperation or weakness but rather I saw this as a mark of strength and conviction which I thought our shareholders would respond to in a positive way. I am pleased to say that on this occasion my instincts were correct and this action, swiftly gave us a firm financial footing from which to move forwards, and has been an important factor in the recovery of Xstrata's share price, which has risen almost 400% since the announcement.

But perhaps the most important thing we did, which enabled the Group to take this decisive and quick action, was to re-examine critically and ultimately reassert our convictions of the evolution of our industry and of our organisation strategy.

Xstrata embarked on its current strategy with an initial public offering in London 8 years ago. At that time, my management team and I set out a number of key convictions on which we based this strategy to build a new, diversified mining company.

One of the most fundamental of these was our belief that on the one hand, the supply-side of our industry was fractured and incapable of rapidly growing supply and that on the other, demand for commodities would rise significantly, meaning supply would struggle to keep pace with demand over the medium term, reversing a multi-decade trend of falling commodity prices in real terms.

We had seen the mining industry endure a long period of low prices throughout the 1990s and the early years of this century. During that time, accountants had largely taken over from engineers at the top of mining companies. Accountants were less interested in building new mines and finding new deposits for the sake of engineering success and much more interested in getting

a decent return on their investment – something the mining industry had been particularly poor at delivering historically. Consequently, and against the backdrop of continued weak commodity prices, investment in exploration declined, fewer new mines were commissioned and the industry attempted to curb the overcapacity that had been built up in the preceding years and decades. The medicine worked and the industry started to make modest returns. But this new breed of mining chief was inherently conservative, and found it difficult to believe that the prevailing trend of declining commodity prices would ever reverse. So new capacity remained unbuilt and exploration spending remained very low. As a result, the mining industry's ability to bring on new supply quickly in response to the burgeoning demand from China was fatally wounded – the implications of which continue to reverberate today. For example, existing mines are suffering from ever-decreasing grades (that is, the percentage of metal contained in each tonne of ore that is mined is falling) and new projects are taking longer than planned to come on-stream, largely as a result of being in complex locations, such as the Democratic Republic of Congo, where the environment is not yet conducive to large-scale investment by international companies. Increased demand from developing markets has resulted in mines depleting even faster, while

exploration for new significant mines has not been as successful in the last decade as the one before. In fact in copper, projections of supply made in 2007 of new copper expected to come on-stream by 2020 had fallen by a cumulative amount of some 21 million tonnes by the end of 2009 – or an average of 2 million tonnes per year. This is for an industry that only produces 18 million tonnes annually in total today. There is simply no confidence in the ability of the copper industry to supply into long-term demand.

Slide 3: Multi-decade secular price trends are not unprecedented

From the start of our journey in building Xstrata in late 2001, we believed this inability to ramp up new sources of production was very important, because of our conviction of rising demand. Secular changes in demand have occurred previously - in the industrialisation of the US at the turn of the 20th century, during the reconstruction of Europe after the Second World War and during the industrialisation of Japan in the 60s and 70s.

Slide 4: Commodity super-cycle driven by urbanisation and industrialisation

However, the key difference with the current secular change is its sheer scale - we are dealing with the urbanisation and industrialisation of over one third of the world's population in China, but also in India, Brazil and other developing countries, especially in South East Asia. In fact, over 400 million people are expected to move to urban centres over the next ten years. And as countries industrialise, the intensity with which they use metals and energy per capita increases. For example, in 2006, 3 kilograms of copper were used per capita in China. As GDP per capita increases, consumption is expected to grow to 9 kilograms per capita as increased affluence results in demand for more buildings, fridges, cars, and so on. This dynamic of increased intensity of use is at the centre of our belief in a secular change in demand.

I can't claim that we foresaw initially how quickly the China effect would ignite demand for commodities, nor the stunning impact it would have on commodity markets just a couple of years later. But I think I can lay claim to the fact that Xstrata was one of the first mining companies to talk about this phenomenon and to

suggest that it could lead to a period of higher average commodity prices. Amongst a number of other key beliefs – such as a commitment to scale and diversity as key sources of advantage in an increasingly globalising and consolidating mining industry – those core convictions enabled us to build Xstrata through acquisitions that were largely unchallenged in the early years, since we had a different view of the world from our competitors. It wasn't long, though, before the rest of the industry got religion.

So in the aftermath of the world's largest financial crisis for almost a century, we looked at these convictions anew and found that, despite this dramatic turn of events, our analysis showed that neither of these trends had been permanently arrested or reversed. While the western economies were down and out and might take some time to recover, the driving forces of constrained supply and strong demand would at some point reassert themselves.

In fact, one of the most significant impacts of the recent downturn for the mining industry has been the extent to which it has exacerbated the supply constraints that already existed. The mining industry's swingeing cuts to expenditure on exploration, projects and infrastructure in response to the financial crisis has delayed the onset of new capacity by at least 18 to 24 months

and means the supply-side will fall further behind in its ability to supply even modest increases in future demand. A lack of both credit availability and access to equity markets also forced many junior miners to suspend or cancel exploration investment, with forecast expenditure in 2010 expected to remain subdued at less than 50 per cent of spending originally planned prior to the crisis.

On the demand side, the global slowdown led to a period of unprecedented destocking of commodities as I have mentioned. But even at the nadir of the crisis, commodity prices did not test their historical lows. Very weak demand from the OECD economies was partially offset by ongoing demand from China, India and Brazil, albeit at lower levels than in previous years. The downturn also underlined China's position as the dominant global user of commodities, with China accounting for over 100% of the growth in consumption in 2009 in a number of metals including copper and zinc.

During 2009, government spending came to the rescue of the global economy, and most major economies unveiled significant fiscal and monetary stimulus packages, of a scale not seen before. In particular, the determination of China to sustain its economic development was underpinned by a stimulus package amounting to more than 2.5 trillion dollars or 12% of Chinese national GDP. China's stimulus was weighted towards substantial public

investment in construction and infrastructure development, giving rise to robust demand for the commodities required to construct this infrastructure. In 2009, fixed investment alone contributed 41% to Chinese GDP, growing by 30% on the year before.

These initiatives were broadly successful in improving liquidity and stimulating investment and consumption demand, and economic activity began to recover during 2009. Commodity prices rose accordingly, staging a strong recovery from the very depressed prices in early 2009, although they remained some way below 2008 levels.

But while the Chinese, Indian and Brazilian economies continued to grow through the financial crisis, the OECD countries – which are dependent largely on consumer spending – experienced deep recessions. The downturn exacerbated the already growing gap in relative growth between developing and OECD economies. OECD consumers are now pursuing the dual objective of reduced debt levels and increased savings, resulting in an extended period of weak domestic consumption. At the same time, infrastructure spend, industrial investment and growing domestic demand are underpinning developing market growth. These divergent dynamics are leading to the so-called ‘two-speed’ global economy.

So what can we expect in the short-term?

My view of the global economy in the short-term is influenced by Xstrata's proprietary early warning system, which tracks a number of leading indicators of economic conditions and end-use commodity user segments to assess the likely direction of the global economy and the key markets for our products over the next three to nine months. Let me hasten to add that alas this tool was only developed after the crisis! But at least we can say in Business School speak that we are a learning organisation. This analysis shows many encouraging signs that consumer and business confidence and manufacturing PMIs are increasing from the very depressed levels we saw last year in most major economies. Consumer confidence in the US rose to 54.2 in February, indicating an expectation of growth in spending. In the OECD, recovery looks set to continue in 2010, although our analysis indicates that the rate of recovery may be slowing after the rapid rebound seen late last year. Japanese industrial production fell 0.9% in March, after rising for 11 consecutive months.

Slide 5: The US consumer remains key to global durable goods demand and global trade

This slide shows us that the US consumer remains key to global durable goods demand and global trade. Even in 2020 they will dominate this aspect of the world economy. Sustained growth is dependent on private domestic consumption and trade. Without this all the infrastructure spend which is currently fuelling the Chinese economy will dissipate in effect and value.

Now, we are likely to see a reduced rate of growth from these economies for some time as consumers continue to reduce household indebtedness in the face of record unemployment. In the US – the world’s largest consumer base - which contributed over 18% to global GDP prior to the financial crisis – consumers had been increasing their levels of household debt steadily since the onset of Reaganomics in the early nineties, with total household borrowings reaching a high of 98% of US GDP in the years prior to the downturn. At the same time, US consumers reduced their savings rates from historical averages of 8.5% to a low of 0.5% of disposable income (by comparison, Chinese consumers save more than 50% of their disposable incomes). The financial crisis resulted in a reversal of these two trends – nervous

US consumers began saving more, increasing their savings to an average of 5.4% by late 2009 while simultaneously reducing their household borrowings. The combination of these two actions has removed substantial liquidity from the US and, effectively, global economies, reducing consumer expenditure, the engine for growth in developed economies.

Slide 6: Short-term lead indicators point to recovery but structural issues remain

Recent data indicates that while the physical indicators of growth are moving ahead positively, credit expansion is still moribund, with mortgage rate spreads still rising and commercial loan growth falling in the US in February. Similar dynamics are in evidence in Japan, with bank lending still trending downward despite central stimulus. Concerns over sovereign risk, the scaling back of quantitative easing and the fragility of the global financial system are also likely to weigh on economic growth in 2010. These factors imply that we will remain in a period of volatility and uncertainty with regard to OECD recovery. Nonetheless, demand for commodities is likely to benefit from further restocking taking place – early signs of which are already in

evidence - following the severe destocking that took place in 2008, providing support to commodity prices, before a more sustainable recovery takes hold.

In China, India and Brazil – easily the most important economies for growth in commodity demand – leading indicators of industrial production remain very robust. In China, private investment and domestic spending are likely to continue to offset reduced public expenditure resulting from the gradual withdrawal of stimulus and anaemic exports – which of course depend to a large extent on the US consumer. China exceeded its target of 8% annual GDP growth in 2009, despite the first year in two decades of negative export growth, and looks set to continue to grow at a similar rate or higher this year. Similarly, indicators suggest that India will continue to enjoy strong economic growth in 2010. For China, the key risks are inflation and potential overheating, given the volume of liquidity injected into the system, set against the risk of a too sudden withdrawal of stimulus spending, which could reverse the recovery under way. Inflation was close to 3% in February and recent measures by the Chinese government to tighten lending and reduce the risk of real estate bubbles reflect a clear desire by policy makers to attempt to balance these competing risks and keep the economy growing at a sustainable rate between 8% and 10%.

Looking further out, the medium term outlook for commodities remains very promising. The driving forces of industrialisation and urbanisation were barely impacted by the global downturn and seem unlikely to be significantly disrupted for some time to come. These generational shifts in population and the infrastructure investment required to accommodate hundreds of millions of new city dwellers will require substantial new sources of key commodities such as iron ore, coal, copper, nickel and zinc. In time, demand from the OECD will also return to a more normalised level supported by the need in many countries to repair or replace aging infrastructure – leading to a period of synchronous demand from both East and West.

I've already discussed the difficulty the supply-side has to supply into this demand. Add to this the huge costs, social and environmental risks, operational and technical difficulties, potential political risks and other possible delays inherent in developing any greenfield mining project today, even in benign economic circumstances, and it is not hard to imagine a scenario in which the supply of certain commodities falls significantly short of demand.

And I dare to say – we remain in the super cycle!

A further key element of work we carried out was a scenario planning exercise undertaken during 2009. Many of you will be familiar with scenario planning but for those who are not, it is essentially a tool that seeks to identify the most critical uncertainties for a business over a longer time frame – in our case 5 to 10 years – with a view to developing plausible scenarios that might eventuate, and to test strategy and assumptions against these scenarios.

This exercise identified three distinct trends or uncertainties that we believe would be fundamental to our strategy going forward. The first, perhaps predictably, related to the outlook for commodity demand in industrialising economies, predominantly China and India and identified the high likelihood that the secular trend of stronger demand would reassert itself over that timeframe.

Second, as recovery gathers pace, the likelihood of scarcity of supply in some commodities required for ongoing economic development is further fuelling the political imperative for developing economies to secure the supply of raw materials

essential to continued economic growth. In the past two years, Chinese companies alone invested some \$40 billion in acquisitions in the commodity sector offshore as part of China's 'going out' strategy – a trend that is highly unlikely to reverse and that presents both opportunities for mutually beneficial partnerships and the potential for competitive threat to traditional mining companies.

The third trend highlighted another interesting critical uncertainty, namely the role of government in the mining industry. This is of course a very broad heading which encompasses everything from changes to legislation or royalties and taxes to the direct intervention of state-sponsored companies or governments as major producers of commodities or investors in mines. Here too we saw risks to commodity producers and to entire commodity industries of increased state interventionism and state capitalism in the commodities sector, based on the misplaced belief that because mineral reserves are not fungible, global mining companies have no options in terms of their alternative destinations for their investment. Major global diversifieds have operations and projects across the globe and continuously seek to optimise their allocation of investment dollars based on the expected attractiveness of each project and,

of course, each location. Uncertainty in a particular country around the financial, political or regulatory regime and how it relates to the ability to predict long-term returns is an obstacle to investment, resulting in the diversion of investments to other more attractive locations. Xstrata, for example, operates in around 20 countries and we are currently considering the relative attractiveness of 20 projects across the globe.

A 'Super-Cycle' can generate significant profits for mining companies, but it should also result in lasting benefits for host nations, in terms of social and economic capital that outlives the lifespan of any one mining operation – for example, improved education and health services, better standards of housing and amenities, enhanced skills development and employment opportunities within and outside the mining industry, as well as foreign exchange earnings and value addition through upgrading of local raw materials in appropriate beneficiation.

However, in practice, a number of significant commodity-producing countries did not benefit from the last commodity boom to the extent that might have been expected. The reasons for this are manifold and differ greatly from country to country.

Nonetheless there are some distinct common features which I think are worth examining.

Of course, the differing success of countries to attract significant investment in resources depends, to some extent, on the richness, accessibility and geographic location of its resources relative to key customer markets. But these major investment decisions depend at least as much on political, regulatory, security, fiscal and social considerations - conditions over which governments have significant control.

The development of a nation's mineral wealth requires very substantial sums of money to be spent over several years, often in projects which yield returns only years after the initial investment. It also requires ongoing investment in the substantial infrastructure required for a successful export and local minerals industry, such as transport, energy, water and other supportive factors to enable ongoing investment and growth.

However, in order to make these long-horizon investment decisions, major mining companies – and the investors whose money ultimately funds these companies – require an investment climate with a number of prerequisites:

First, governments must facilitate the creation of a clear, integrated long term plan for their metals and mining industries, identifying the potential and goals of the industry and acknowledging mutually-reinforcing roles for government, the public sector, organised labour, educational institutions, industry itself and other key stakeholders.

Slide 7: Prerequisites for investment in mining

Government's primary role is to establish the conditions for a facilitative environment in which all the actors in the industry overall can flourish. Let's look at four key areas:

- **Certainty and stability:** Stable regulatory regimes are essential to provide a basis for long-term investment decisions. Certainty over the prevailing fiscal and regulatory regime provides foreign investors with greater clarity over the likely returns on their potential investment, increasing the likelihood that the decision to invest in viable mines and projects will be made. A stable regime also enables a more stable flow of taxes and royalties to government, improving their ability to plan. In the rare event that changes are

required to the regulatory regime, two important principles come into play – first, a legitimate consultative process should precede any changes and, second, the application of changes retrospectively to existing operations should be avoided to prevent deterring future investment.

- **Transparency and security of tenure** are central to instilling confidence in a country: Lack of transparency, for example, over the use or collection of mining revenues, or the basis for licensing, lease tenure and other decisions, creates enormous uncertainty and effectively erodes the investment credentials of the country over time.
- **Furthermore, natural resource companies require the infrastructure to maximise their production, effectiveness and investment.** The inability of regional or national authorities to create the conditions for the effective provision of rail, ports, roads, electricity, water, access to finance and other basic support functions creates enormous difficulties for mining companies and for the communities that could benefit from their investment. Insufficient infrastructure can be a significant barrier to investment in and optimisation of a region's natural resources.

Finally, the broad set of **skills and capabilities** required by natural resource companies and their support services - especially technical expertise – are the lifeblood of a thriving mining industry. Government, education institutions such as Wits, and the industry all have a central role to play in ensuring a constant pipeline of this vital human capacity exists.

I am pleased to see that at the recent Mining Summit convened by the South African government, mining industry stakeholders have already begun discussing seriously all of these issues in the South African context. It is, however, critical that we quickly transform our intentions into detailed, actionable plans to deliver the improvements necessary to position the industry for future growth and Xstrata is committed to playing our part in this process, along with our many other stakeholders.

Governments in countries such as Chile have long recognised the central role they can play in promoting a flourishing mining industry that optimises the use of the country's natural resources for the benefit of all stakeholders on a sustainable basis. Between 2001 and 2008, the Chilean mining industry's contribution to GDP grew by a compound annual rate of 12% in real terms. It's

no surprise that Chile was ranked first in the region by the recent WEF Competitiveness Rankings.

Similarly, the mining industry's contribution to the Australian, Colombian and Peruvian economies – all countries in which we operate – grew by 6 to 7% per annum over the same period.

There are, however, many countries where the potential of the available resources has never been realised due to corruption, capricious short-term legislation that deters responsible investment, lack of transparency, poor or deteriorating infrastructure, political instability and civil war and lack of skills.

Nigeria is one well-recognised and particularly severe example, where a burgeoning oil industry based on vast oil reserves has stalled, with production falling by over 10% in the last three years during a period of peak oil prices to below Nigeria's OPEC quota, as foreign operators withdraw investment in the face of endemic corruption, uncontrolled security risks, significantly higher royalty levels, windfall taxes and impractical local content requirements. As a result, Nigeria is missing a golden opportunity to benefit from robust oil prices to create employment and lasting benefits for its people that would outlast the oil reserves.

Slide 8: Contribution of SA mining industry to GDP has declined during one of the biggest mining booms

And even in South Africa, which has many of the factors required for successful investment, the mining sector is unable to reach its full potential. A study by Global Insight shows that, while Chile's mining industry added to the country's wealth and China's mining industry contributed 19% to GDP during the period from 2001 to 2008, for South Africa over the same period, the mining sector's GDP contribution actually shrank by 1% during one of the greatest natural resource booms in history. This is despite vast resources in key commodities in demand by developing economies, such as coal, ferrochrome and platinum. According to a McKinsey study, if, instead of shrinking, South Africa's mining industry had achieved the average rate of growth in value creation of the mining industry across the world of 5% per annum during this period, approximately 45,000 additional mining jobs could have been created and a total of \$8 billion or ZAR60 billion of additional GDP could have been contributed by the mining sector.

Restricted and unstable energy and transport infrastructure, shortages of skilled labour - in particular engineers, geologists

and artisans - and the constrained capacity within regulatory bodies to satisfy significant volumes of licensing or permitting applications have prevented our country from reaping the full benefit of the first phase of the commodities boom. In the not too distant future, underinvestment in water-related infrastructure risks pitting industry against its own communities as water scarcity grows.

But it doesn't have to be this way. Government and a participative industry with a common vision **can** restore the South African minerals industry to growth, competitiveness, job creation and the ability to capture value from the ongoing 'Super Cycle'. Transformation of the mining industry to provide even greater, broad-based participation is clearly vital to achieving this goal and despite progress in a number of areas, including within our own portfolio, there is much yet to be achieved here.

Security of energy supply is crucial. A shortage of energy generation capacity has already stalled further investment in mining and beneficiation capacity, losing with it the potential for thousands of jobs and the associated revenue and foreign exchange this production would earn for the country. Xstrata itself has had to put on hold a R5 billion investment in the expansion of our ferrochrome business – an investment which could create around 2,000 construction jobs and 500 permanent

employment opportunities, while generating additional foreign revenues of over R5.4 billion per year at current prices from the beneficiation of local ores.

There is no simple or immediate remedy to the electricity constraints. But we urgently need a realistic assessment of the roles of each player in the solution – Eskom alone cannot do it! Further we need urgent policy and regulatory changes to facilitate credible and sustainable electricity generation. In the medium term, viable solutions include the participation of energy intensive companies such as ours in the construction of ‘own generation’ capacity aimed at satisfying our own demand, thereby relieving Eskom of the financial and execution burden and risks, while at the same time enabling us to secure the future of our operations, their competitiveness and allowing further investment in our South African businesses.

The skills shortage is more acute in South Africa than in most of the countries around the world in which we operate – a legacy of the poor education and underinvestment in technical educational institutions South Africa suffered in the past, which have undermined our country’s ability to develop new engineers and skilled tradespeople to fill the vacancies that will be created. This issue requires a holistic approach from primary education through to the provision of bursaries and apprenticeships. Education is an

area in which Xstrata has been particularly active over the past seven or eight years, supporting initiatives to improve school governance, providing financial support for students to enable them to continue in their studies, funding matriculation programmes that enable students to retake key examinations with the potential for work placements or bursaries for further study if they succeed – in addition to comprehensive workplace traineeships and community skills development centres. Our investment in the new engineering facilities at Wits University is a further sign of our commitment to working collaboratively with other stakeholders to find solutions. Industry participants, government and educational institutions have to come together to create the much needed technical skill base to ensure our industry is able to thrive into the future and play an expanded role in contributing to South Africa's economic growth. However, the essence of this complex problem, as I have said, starts at school. The current school system is not up to the task. We can have many debates about this but I think that there are two ways in which the situation can be improved with results that can be measured over a four or five year period.

Firstly, the standard of education will not improve unless the standard of teaching improves. Teachers need training and this is an area where the private sector can and should help. Further

there are a number of retired teachers who should be enticed back from retirement in the short term.

Secondly, we should implement a “Teach First “programme in South Africa, where our top graduates are encouraged to teach for a two or three year period in the more challenged schools before embarking on their chosen careers. Here again the private sector can partner government by offering a stipend to supplement their salaries and committing to employ these graduates post their assignments. There is nothing better in encouraging, motivating and inspiring young people to excel than great role models, which these Teach First graduates will be!

The wider continent of Africa is home to some of the richest untapped mineral deposits in the world. In due course, these resources will be developed as the world requires new sources of supply, and South Africa has an opportunity to become the centre of mining finance for the continent, as Africa becomes the next major copper and cobalt-producing region of the world. But the restrictions that currently exist prevent foreign-listed companies from enjoying full indexation on the JSE, coupled with ongoing exchange controls, make this vision almost impossible to achieve. Amendments to these regulations could open up the JSE to the world’s major mining companies and aspirant regional

players, attracting additional investment flows, and encouraging the re-establishment of a centre of mining finance excellence.

Slide 9: attributes of successful mining companies

As for mining companies, what attributes are required to prosper from the super-cycle?

In my view, growth and momentum remain the key ingredients for ongoing success. We work in an industry where our assets waste away, making the replenishment of reserves and resources a never-ending task. So, in order to benefit from the continued positive demand trend, we must secure access to sufficient new sources of raw materials not only to replace dwindling resources but to grow our operations and production substantially to meet rising demand and capture the benefit of higher average prices for our products.

By way of example at Xstrata, growth has always been part of our DNA. While acquisitions gave us immediate scale and entry into new commodities in the first five years of our development, importantly they also brought a range of organic growth opportunities into our portfolio. We have invested in and

developed those projects and others from the earliest stages of exploration through the various stages of a mining project's life cycle, successfully completing the construction of 13 major projects in the past five years and bringing us to the point today where we have over ten additional projects currently in construction, with a further ten due to come to the Xstrata Board for approval during this year. We now enjoy an organic growth pipeline which will increase our production volumes by some 50% and, since our new mines are also lower cost operations, will also deliver cost reductions of between 25 and 30% over current levels by 2014.

The second imperative I mentioned, momentum, comes from the ability within the organisation to create and seize opportunities as they arise. Apart from the obvious pitfall of exhausting one's resource base, a mining company that fails to actively pursue external and internal opportunities to create value typically has very little resource or capability to act successfully once opportunities do present themselves. I have always emphasised the importance of momentum within Xstrata - people in our organisation are encouraged to move forwards all the time, seeking new opportunities to add value in very practical ways and I believe that this is essential for success for any company in our sector.

Another critically important ingredient for success is the ability to demonstrate that we are responsible owners and operators of natural resources. To gain access to new resources and to obtain a so-called social licence to operate – in other words, broad-based community support for our activities – companies must have a strong track record in developing and investing in resources in a socially and environmentally responsible manner. This means providing lasting economic and social benefits for communities that outlive our operations, forming mutually beneficial partnerships with other stakeholders, respecting local people’s customs and traditions and managing our environmental impacts responsibly, to return the land for other uses once mining is completed. Safety in the workplace is perhaps the most important consideration of all and I have never accepted that safety performance in South Africa should be any different to any other region of the world. I am therefore pleased to note that the South African mining industry as a whole is making progress in improving safety performance and reducing fatalities. I know from our own experience that innovative initiatives, visible leadership and effective training can make an enormous difference in ensuring that our workforce returns home safely at the end of each day’s work.

Other attributes worth highlighting include scale and diversity – twin drivers of the consolidation we have seen in the mining industry over the past several years. Scale is not about being the biggest for ego’s sake. Achieving scale provides the ability to own and develop several large projects without risking a substantial portion of the company’s capital in any one region or on any one project. Scale also brings an improved ability to access capital, talent and new resources and to capture external opportunities.

Aligned to scale, diversity is also about managing risk, by spreading investments across different geographies and different commodity markets. The scale and diversity Xstrata has built up over the past several years has enabled us to commence the substantial capital investment programme we have under way, which will see us spend over 14 billion dollars in the next three years to develop new mines that will start production at a time when the world is expected to be structurally short of commodities.

People, their skills and capabilities are, of course, central to any company’s success. One aspect of this which bears mentioning is that generally value is created by skilled and gifted people in activities which can best be described as incremental. My own mentor Dr John Maree used a phrase: “Think Big, See Small”. I subscribe to this maxim. Great vision is important and now and

again great ideas do give rise to great deeds which generate huge value. But more often than not the value creation of great companies comes from small incremental steps by skilled employees who every day try to run the business more effectively and more efficiently than the day before. Seeing small is the key skill that employees need to cultivate.

However, the most capable and committed people cannot flourish and extend themselves beyond their own expectations without a working environment which gives them the space and the authority to achieve extraordinary things.

While it's unusual for mining companies to discuss this, I believe strongly that the secret to our success to date lies in an organisational strategy which is really quite unusual – certainly unique in our sector. At the core of our powerful organisation strategy is the entrepreneurial mindset that pervades all levels of our organisation. There truly is an 'owner-operator' culture in Xstrata engendered through the emphasis of authority and responsibility at the operational level. Managers are wholly accountable and responsible for their operations, organised within commodity businesses that are, themselves, resourced to operate as global businesses. At the same time, these

autonomous businesses are not burdened either by significant 'head office' costs nor the traditional 'second-guessing' that characterises centralised mining houses. The head office is kept to a minimum – in our case some 40 people in total in a company with over 60,000 employees. No one at the centre can second guess operational management's decisions, because we don't aspire to have mining or technical expertise sitting at the centre. The other side of the coin, therefore, is that there can be few excuses for poor performance due to the clear delineation of roles between the Centre and the Business Units and the absolute accountability for results, within the Group's policies and standards.

As a result, we attract and grow executives who seek to identify and capture value at every turn, are prepared to take calculated risks to push boundaries, reap the rewards for their successes or, on the odd occasion, learn from their mistakes. This organisational strategy has stood us in good stead as we have grown from a market value of 500 million dollars to a 50 billion dollar global diversified major in only 8 years and has stood the test of a rapid acquisition-led growth phase, a very severe economic downturn and, now, a period of more organically-orientated growth.

All of these are, in my view, important attributes enabling a multinational organisation to respond promptly to market conditions and to continue to grow profitably and sustainably with the support of its employees.

Conclusion

Xstrata with its Swiss/Anglo roots is an important investor in South Africa although only 15% of our assets are located here. Just as we have put in place the key elements that will enable Xstrata to benefit from the next super-cycle, as a fellow South African, I am eager to see South Africa prepare itself to do the same. The anguish of lost opportunities is valuable in generating greater determination to overcome challenges. Just as Xstrata has learnt from mistakes, I am hopeful, as a South African - educated in South African and heading a team of many world class South African businessmen – that our country can grasp the global opportunities which still await the SA mining industry.

I have been encouraged by some of the recent initiatives under way to bring together the mining industry, national and provincial government, regulators, civil society and partner organisations such as Eskom to set out a long-term strategy for the development of South Africa's mineral industry and to tackle

some of the key impediments to global competitiveness. We are keen to play an active role in these initiatives and I hope that the collective efforts of right minded people will ensure that South Africa captures the full benefit of the next commodity boom, for the long-term prosperity of all of her people.

Thank you.

Slide 11: Cover Slide