Results and financial review

David Abery, Finance Director

The superior asset and production growth that Petra has recorded in the last few years has now translated into financial results for our shareholders...

The full year results comprise results from Cullinan, Koffiefontein, the fissure mines, the bulk sampling programme at Williamson (which stopped on 1 April 2010, followed by the commencement of the capital expansion programme), and the care and maintenance costs of Kimberley Underground until the acquisition officially completed on 19 May 2010.

Revenue

Gross revenue of US$177.7 million was recorded for the Period, an increase of 88% on the US$94.4 million recorded in the 12 months to 30 June 2009. Group revenue was up 136% to US$163.7 million, against the US$69.3 million recorded in the 12 months to 30 June 2009. A direct comparison of Group revenues between the periods is complicated due to the increased interest in Cullinan acquired during the Period. For future reporting periods, Petra will consolidate 100% of the results for the Cullinan mine and this is expected to further significantly increase Group revenue and EBITDA.

With our operations mainly in South Africa, but our diamond sales based in dollars, the volatility and movement in the Rand is a significant factor to the Group. In the Period under review, the Rand traded in a range of R7.17/US$1 and R8.31/US$1, averaging R7.61 for the year (FY2009: R9.05).

Mining and processing costs

Mining and processing unit costs (before depreciation) for the South African operations increased in ZAR terms by approximately 3%, being largely due to upwards pressure on electricity and labour costs experienced for the Period, offset by increased throughput of both underground and tailings tonnes. In US$ reporting terms, mining and processing costs have increased further due to the strengthening of the Rand during the Period by approximately 15.9%, the consolidation of 100% of the mining and processing costs for Cullinan from 17 November 2009, the inclusion of Williamson for the full Period and the start-up of the Kimberley Underground operations late in the Period.

Mining profit

A profit on mining activity of US$67.2 million was recorded for the Period, against a profit of US$7.8 million for the corresponding period. These strong results reflect the robust nature of Petra's assets, which were net profitable even throughout the downturn. Petra's mines generally operate at healthy margins, which bodes well for the 2011 financial year, when management expects to see higher average diamond prices than FY2010.

Other income

As at 1 July 2009, the Company had written down to zero the carrying value of the plant and equipment that remained in Angola following its withdrawal from the Alto Cuilo and Luangue projects. These assets were sold during the Period for US$3.7 million cash and a profit on disposal of the assets of US$3.7 million is included within other income.

During the Period, Petra exchanged its interest in the Kono project in Sierra Leone with Stellar, the project's joint venture partner, for a total consideration of US$0.9 million, that was settled by the issue to Petra of 4,500,000 new ordinary Stellar shares.

The management consultancy fees of US$0.8 million arose due to Petra's recharge of management internal resources to third parties.

Exploration income

Petra Diamonds is focused primarily on production, but it has retained some exposure to exploration whilst minimising funding commitments. The Group's modest annual exploration budget is now focused in Botswana, which is considered to offer a highly attractive operating environment. The net exploration income for the Period (excluding amortisation charges) is comprised of exploration costs in Botswana of US$0.8 million and a one-off credit of US$2 million. Further to the Company's withdrawal from Angola, provisions for withdrawal and associated costs of US$2 million were no longer required and were therefore credited to the income statement within exploration income.

During the Period, the Company took the last required charge for the amortisation of the licences in Botswana and there will be no further amortisation charges in this respect for future accounting periods.

Corporate overhead

Corporate overheads (before depreciation and share-based payments) increased to US$7.5 million for the Period (US$5.9 million in FY2009). This was largely due to an increase to staff costs, rising from US$2.4 million (FY2009) to US$3.6 million (FY2010), in line with Petra's growth for the Period.

Inventory fair value adjustment

During the Period the Group sold the 168 carat and 507 carat Cullinan stones for US$6.3 million and US$35.3 million respectively. At mine level this realised a profit of US$41.6 million, as the production cost for the stones was not material. On acquiring the second 50% of Cullinan Investment Holdings Limited ("CIHL"), management prudently estimated the value of the stones for accounting purposes at US$19 million, and this became the cost to the Group for IFRS reporting purposes. The deferred taxation on the inventory fair value adjustment of US$7.4 million was realised on the sale of inventories that had been fair valued as at the acquisition date.

Cullinan fair value adjustment

The Cullinan fair value adjustment of US$31 million arises due to the acquisition of the second 50% of CIHL, which has been treated as a stepped acquisition under IFRS 3 (revised). The fair value gain of US$31 million reflects the difference between the book value of the original 50% interest in CIHL and the fair value (as determined by the price paid for the second 50%) of the net assets held at the time that the second 50% was acquired. A significant component of this relates to the difference between the production cost of the exceptional Cullinan stones and management's valuation of these stones. In assessing the fair values of the second 50% of net assets acquired, management has allocated the premium of consideration over net assets to mineral rights and inventories.

Recycling of foreign exchange differences on exploration projects

In prior periods, foreign exchange gains relating to Petra's exploration assets in Angola were taken directly to reserves. Following the Group's exit from Angola and disposal of the remaining assets, these gains have been taken to the income statement, in accordance with accounting standards.

Net unrealised foreign exchange gain

During the Period, the Group generated net unrealised foreign exchange gains, the majority of which are due to unrealised foreign exchange movements on the annual restatement of foreign subsidiary intercompany loans.

Net finance expense

The Group incurred net finance costs of US$0.5 million (US$6.3 million in FY2009), being interest payable on the Al Rajhi loan, the Al Rajhi convertible loan (which was settled in December 2009), the Group's working capital facility and the fair value adjustment on the CIHL/Al Rajhi deferred cash consideration, offset by interest received on cash balance, interest received from the Cullinan BEE partners loans and realised foreign exchange gains of US$4.2 million (primarily on settlement of the Al Rajhi convertible loan).

Tax credit

A tax credit of US$1.2 million (US$3.4 million in FY2009) was recorded, being tax payable of US$0.1 million by Premier Rose and Blue Diamond Mines, tax refundable of US$0.2 million to Messina Diamonds and Dancarl Diamonds, deferred tax debit of US$10.4 million for Cullinan, Crown Resources and Messina Diamonds and deferred tax credits of US$3.8 million for Dancarl Diamonds and US$7.4 million in respect of deferred tax liabilities recognised on the step-up acquisition of CIHL.

Group profit

A net profit after tax of US$70.2 million was recorded for the Period, in comparison to a loss of US$89.0 million for the prior period (of which US$75.3 million was largely attributed to the write-down of Petra's exploration portfolio). The superior asset and production growth that Petra has recorded in the last few years has now translated into financial results for our shareholders, as diamond prices have now recovered and stabilised from the global economic downturn. The Company recorded earnings per share of 22.65 cents, ahead of analyst expectations.

Cash and debt

As at 30 June 2010, Petra had cash at bank of US$34.5 million (17 September 2010: US$32.1 million). Of this total balance at Period end, US$9.7 million is held by Petra's bankers as security for environmental rehabilitation bonds lodged by the bankers with the South African Department of Mineral Resources ("DMR"); the balance of US$24.8 million is unrestricted cash.

As at 30 June 2010, debt and borrowings were largely compromised of the balance of the Al Rajhi Cullinan loan of US$30.7 million principal (plus accrued interest) and the deferred consideration for the Cullinan step-up (37%) due to Al Rajhi in December 2011 of US$32 million (US$35 million gross). These sums due are split between short- and long-term debt.

The only other 'cash' obligations within liabilities are US$16.8 million of trade payables. The balance of liabilities on the balance sheet (which are of a 'non-cash' nature) comprise provisions for various rehabilitation liabilities, accounting for amounts owing due to the financing of the minorities in Cullinan, leave and medical aid provisions and deferred tax.

Petra substantially simplified and strengthened its balance sheet from the proceeds of the share placing and in November 2010 completed the US$83 million debt financing with IFC/RMB, settling the Al Rajhi Cullinan loan shortly thereafter. The Group will only draw-down on these IFC/RMB debt facilities over time, with the funding of the capital expansion programmes at Williamson and Cullinan to be financed from these facilities (and supported by Petra's strong operating cash inflows) stretching over some three years.

Cashflow

Petra's management is focused on cashflow generation from its operations. The Group generated strong operating cashflows for the Period of US$48.8 million (FY2009: US$4.6 million). Group cash was further augmented by net proceeds from the share placing carried out in November/December 2009 of US$113.4 million. Capital expenditure amounted to US$33.4 million, the cost of the acquisition of Kimberley Underground and associated pre-acquisition capital spend were US$18.1 million, and settlement of Group borrowings (including the Al Rajhi convertible and Cullinan loan) were US$91.9 million, taking Group cash balances to US$34.5 million at Period end.

Strengthening the balance sheet

The Company took a number of steps during the Period to significantly strengthen its balance sheet, as outlined below:

Placing raised US$120 million

In December 2009, Petra completed a successful placing to raise gross proceeds of US$120 million (£72.7 million) by the issue of 121,200,000 new Ordinary Shares at a price of 60 pence per share. The Company decided to undertake this placing for the following reasons:

- Acquisition of an additional 37% of the Cullinan mine
  Cullinan is Petra's key asset in terms of the potential for earnings growth and cashflow generation yet the Company previously only had a 37% interest in the mine. Furthermore, cashflows from the mine were ring-fenced to paying down the US$80 million Al Rajhi loan provided in respect to the original acquisition and financing of the mine. Effective 17 November 2009, the Company increased its interest in the Cullinan mine to 74%, by acquiring the 37% interest held by Al Rajhi. The consideration was satisfied by the issue to Al Rajhi of 36 million new Petra shares and a deferred cash consideration of US$35 million, payable December 2011.

  As part of the above transaction, Petra also took over responsibility for the loan due to Al Rajhi, this was previously recognised in the books of Cullinan Investment Holdings Limited and therefore did not form part of the consideration. This loan was reduced to US$50.7 million in December 2009 by the issue of 11.4 million new Petra shares to Al Rajhi and the payment of US$15 million cash from the raising proceeds. Petra reported in its interim results in February 2010 that the principal loan balance had since been reduced to US$43.2 million. In March 2010 a further US$12.5 million was paid to Al Rajhi from Petra's treasury, further reducing the principal loan balance to US$30.7 million. In November 2010, the remainder of the principal loan balance and interest were paid to Al Rajhi.
- Repayment of US$20 million Al Rajhi Convertible Loan Note
  In order to trigger the acquisition of the additional 37% interest in Cullinan from Al Rajhi, it was a requirement that the Convertible Loan Note, plus accrued interest, be settled. In December 2009, post the raising, Petra paid Al Rajhi US$20.5 million and fully settled the Convertible.
- Strengthen Company treasury
  During the course of 2009 Petra's debt levels had increased as, during a period of very weak diamond prices, the Company had invested out of its own cash resources in the construction of the plant and the care and maintenance of the underground operations at Kimberley Underground, development work at Cullinan and the bulk sampling programme at Williamson. Management considered it important in terms of Petra's corporate development to reduce debt to a more appropriate level.

The US$120 million funds raised were therefore applied to:

- strengthen the Company's balance sheet by paying down existing debt (including the US$20 million convertible bond);
- acquire a further 37% interest in Cullinan; and
- bolster the Company's treasury.

Facilities to fund Williamson and Cullinan expansion

In June 2010, Petra agreed terms with IFC (a member of the World Bank Group) and RMB, a division of FirstRand Bank Limited, with regards to new five and a half year debt facilities of approximately US$83 million (US$40 million to be provided by IFC and approximately US$43 million (R300m) to be provided by RMB).

The facilities are being applied to:

- primarily finance the expansions of Williamson and Cullinan (together with contributions from Petra's own treasury);
- general Petra working capital needs, and
- settlement of the outstanding loan due to Al Rajhi, removing this short term debt obligation from Petra's balance sheet.

Further to the completion of this debt transaction in November 2010, the expansion plans for Williamson and Cullinan are now fully financed, assuring the capital roll-out required to take Group annual production to over three million carats.

The strategy behind these financing facilities is to secure funding for Petra's planned expansion programmes and to potentially fund other organic production growth opportunities currently under consideration. These debt facilities may even allow the Company to further fast-track production. The Group will consider carefully whether it needs to take full advantage of the draw-down of these debt facilities, but to secure the financing at this time provides Petra with the scope and flexibility to bring the stated production and revenue growth opportunities to account.

David Abery
Finance Director
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