LETTER TO STAKEHOLDERS

We are pleased to present to you the annual report for the Merafe Group, which includes Merafe Resources Limited (Merafe), a company listed on the JSE Limited, and Merafe Ferrochrome and Mining Proprietary Limited (Merafe Ferrochrome) for the year ended 31 December 2012. The scope of this report includes Merafe, its subsidiaries and the Xstrata-Merafe Chrome Venture (the Venture). There has been no significant change in our size, structure, ownership or products and there are no specific limitations on the scope or boundary of this report.

We published our previous annual report, for the reporting period ended 31 December 2011, in 2012.

We welcome the opportunity that an integrated approach to reporting offers us to break down reporting silos and provide a broader explanation of our performance, underpinned by a strategic focus, connectivity of information, a future orientation and an inclusive and responsible approach to stakeholders. We were delighted when our efforts in this regard resulted in our second integrated report winning the Small Cap section of the Chartered Secretaries Southern Africa/JSE Limited Annual Reports Awards 2012. We have taken the opportunity to feature our two new projects, the Tswelopele pelletising and sintering plant and the Lion II ferrochrome plant, in the photographs we have used in the report this year.

This year we have adopted a five capitals model (natural, human, social, manufactured and financial capital) for our reporting, as recommended in the International Integrated Reporting Committee's (IIRC) discussion paper.

We depend on a variety of resources and relationships for our success. The extent to which we are depleting these or building them up has an important impact on the availability of the resources at our disposal and the relationships that support our long-term viability. The capitals model, by seeing these resources and relationships in terms of 'capital', provides us with a basis for understanding sustainability in terms of the economic concept of wealth creation or 'capital' and encourages us to consider how wider environmental and social issues can affect our long-term profitability.

In addition to following the recommendations contained in King III, the South African Code for the Reporting of Exploration Results, Mineral Resources and Mineral Reserves (SAMREC Code) and the JSE Limited Listings Requirements, we are guided by the Global Reporting Initiative's (GRI) 3.1 Guidelines and our internally developed policies and procedures, in terms of measuring our progress towards sustainability.

KPMG Inc. audits our annual financial statements. In compliance with International Financial Reporting Standards (IFRS), an independent auditors' report on the financial statements contained in this report appears on page 133 of our annual financial statements, which can be found on our website at www.meraferesources.co.za.

In order to ensure that we provide our stakeholders with reliable and accurate information on our sustainability, we engaged KPMG who, as disclosed in this report, assured key Merafe sustainability information on pages 116 to 119 of this report and also completed an independent review of key performance indicators in the Venture, selected by KPMG, which are set out on pages 116 and 117 of this report. In addition, Integrated Reporting and Assurance Services (IRAS) calculated Merafe Resources' carbon footprint as well as assuring its application of King III and the GRI G3.1.



Chris Molefe
Chairman



FORWARD LOOKING STATEMENT

Certain statements in this report constitute "forward looking statements". Such statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performances, objectives or achievements of Merafe Resources Limited and its subsidiary companies, as well as the industries in which it operates, to be materially different from future results, performances, objectives or achievements expressed or implied by these forward looking statements.

The performance of the Merafe Group is subject to the effect of changes in commodity prices, currency fluctuations, uncertainty around the supply of electrical power, the risks involved in mining and smelting operations and the operating procedures and performance of the Venture. The company undertakes no obligation to update publicly or to release any revisions to these forward looking statements to reflect events or circumstances after the date of publication of these pages or to reflect the occurrence of unanticipated events.

Overview

ORGANISATIONAL OVERVIEW AND BUSINESS MODEL

Our **business**

We are listed on the JSE Limited in the General Mining sector under the share code MRF. Currently, the main focus of our business is on the 20.5% participation of our wholly owned subsidiary, Merafe Ferrochrome and Mining Proprietary Limited, in the earnings before tax, depreciation and amortisation (EBITDA) of the Xstrata-Merafe Chrome Venture (the Venture), in which Xstrata has a 79.5% participation.

Merafe and Xstrata South Africa Proprietary Limited (Xstrata) formed the Venture in July 2004 when we pooled our chrome operations to create the largest ferrochrome producer in the world.

For more information on the assets we pooled, of which we have retained ownership, and the additional assets we have invested in since participating in the Venture, see the table on page 36 of the Manufactured capital section of this report.

Stakeholder **relationships**

We believe our commitment to and achievements in terms of empowerment, sustainability and good governance have allowed us to establish long-term relationships with our major shareholders – the Royal Bafokeng Nation (through its investment arm, Royal Bafokeng Resources Holdings) and the Industrial Development Corporation (IDC) – and our partners in the Venture.

Empowerment

Merafe's commitment to empowerment was recognised by the *Financial Mail*'s Top Empowerment Companies Survey in 2012 which rated Merafe as the most empowered company in the South African mining sector in 2012.

Governance and sustainability

Our commitment to good governance and sustainability is reflected in our inclusion in the JSE Socially Responsible Investment (SRI) Index since its inception in 2003.

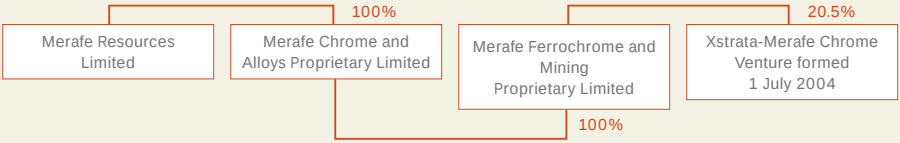
Our material issues

Our material issues are set out on pages 8 to 11 and our approach to risk management is discussed in the Transparency and accountability section of this report on pages 90 to 112.

Our approach to risk

We recognise that risk is inevitable in business and that it goes hand in hand with opportunity. We have established a risk management system that allows us to pursue business opportunities and grow shareholder value, monitor risk in our investments and develop and protect our people, the environment in which the Venture operates and our reputation.

Our structure



For more information on the Merafe Group and structure see pages 129 and 153

Year **in review**

5% increase
in revenue

R314 million
EBITDA

R83 million
cash balance

R512 million
long-term debt

Completed Project Tswelopele on schedule and within budget

Zero
fatalities

Energy efficiency improvement

R257 million
net cash generated from operations

Strong balance sheet

5 cents
HEPS

Most empowered company in the resources sector of the *Financial Mail*'s Top Empowerment Companies Survey in 2012

4.05
TRIFR

Good progress on Lion II

Our **business model and strategy**



Ferrochrome

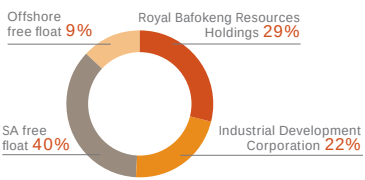
The aim of our business model and strategy is to ensure our ferrochrome interests are profitable and sustainable and that they add value to all our shareholders. We achieve this by:

- extracting chrome ore from the Venture's mines and beneficiating it in its smelters in a safe and cost-efficient manner
- investing in projects that include the Bokamoso and Tswelopele pelletising and sintering plants and the Lion ferrochrome plant Phases I and II that improve the energy efficiency and cost effectiveness of its ferrochrome operations
- employing the Venture's proprietary Premus technology to ensure it is the lowest-cost producer of ferrochrome in South Africa and, despite rising energy costs in South Africa, remains in the lowest quartile of the global ferrochrome production cost curve
- using the flexibility provided by the Venture's variety of technologies to meet changing operating circumstances and customer requirements.

Diversification

Our medium-term objective is not only to grow and improve our ferrochrome operations but to grow through diversification. We are engaging with our stakeholders in this regard and aim to diversify in the medium term. For more information see our CEO's Strategic review on pages 16 to 23.

Our shareholding

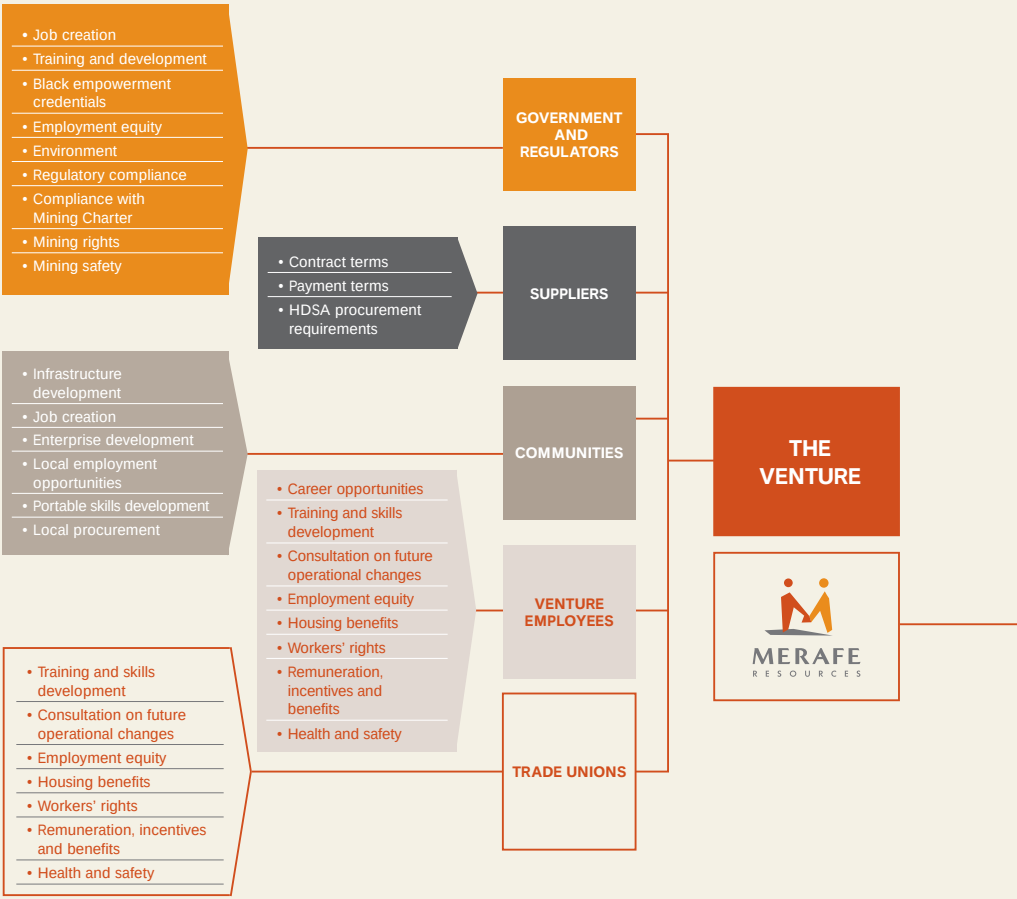


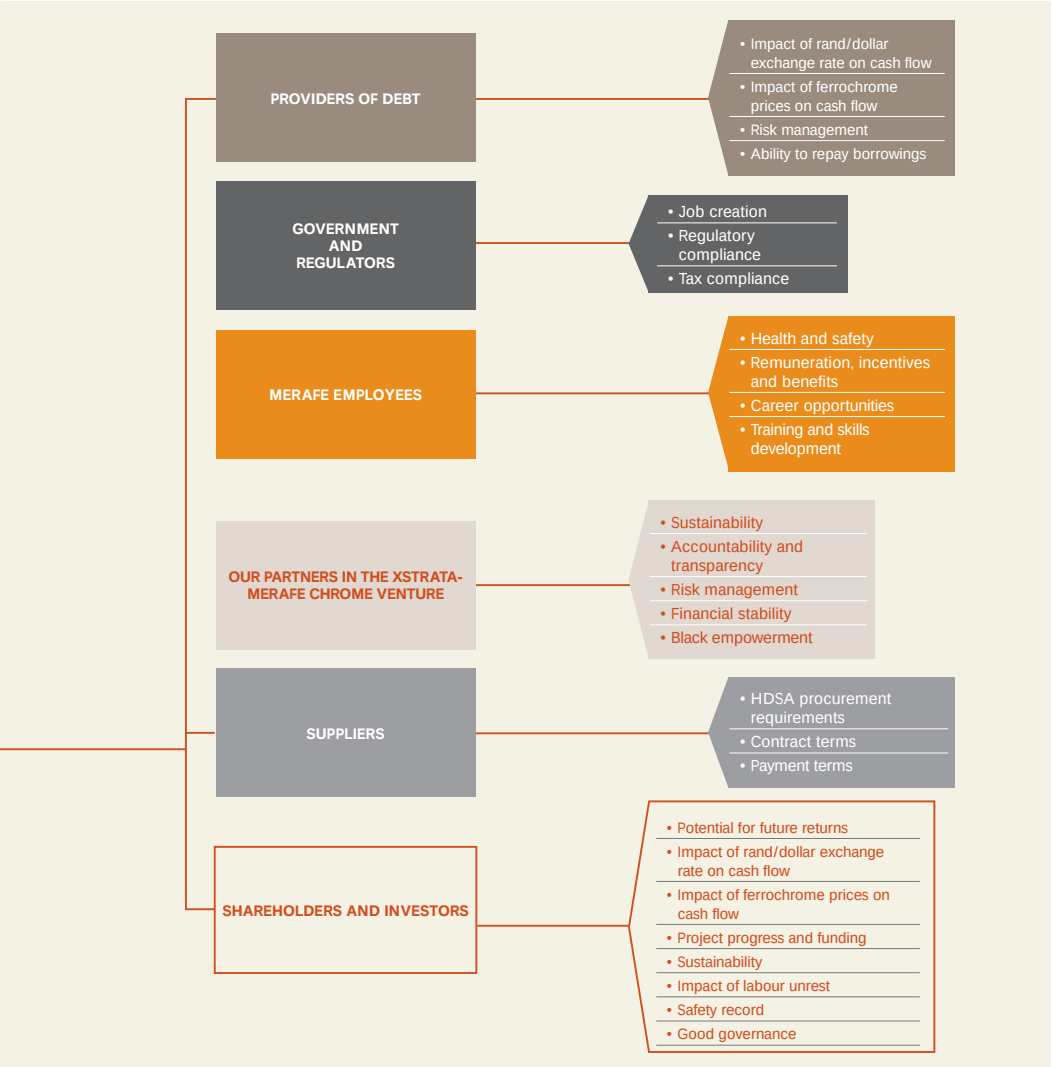
More information on our engagement with our stakeholders is contained in each section of this report and a table containing details of our stakeholders, our methods of engagement with them, the frequency of this engagement, the key topics and concerns raised during these engagements and our responses to them can be found on our website at www.meraferesources.co.za

Overview

OUR STAKEHOLDERS AND ISSUES THAT COULD HAVE A MATERIAL IMPACT ON THEM

Our stakeholders include our shareholders, government and regulators, our joint venture partners, the employees and suppliers of both Merafe and the Venture and the communities in which the Venture operates




PROVIDERS OF DEBT
• Impact of rand/dollar exchange rate on cash flow
• Impact of ferrochrome prices on cash flow
• Risk management
• Ability to repay borrowings
GOVERNMENT AND REGULATORS
• Job creation
• Regulatory compliance
• Tax compliance
MERAFE EMPLOYEES
• Health and safety
• Remuneration, incentives and benefits
• Career opportunities
• Training and skills development
OUR PARTNERS IN THE XSTRATA-MERAFE CHROME VENTURE
• Sustainability
• Accountability and transparency
• Risk management
• Financial stability
• Black empowerment
SUPPLIERS
• HDSA procurement requirements
• Contract terms
• Payment terms
SHAREHOLDERS AND INVESTORS
• Potential for future returns
• Impact of rand/dollar exchange rate on cash flow
• Impact of ferrochrome prices on cash flow
• Project progress and funding
• Sustainability
• Impact of labour unrest
• Safety record
• Good governance

Overview

OUR OPERATING CONTEXT

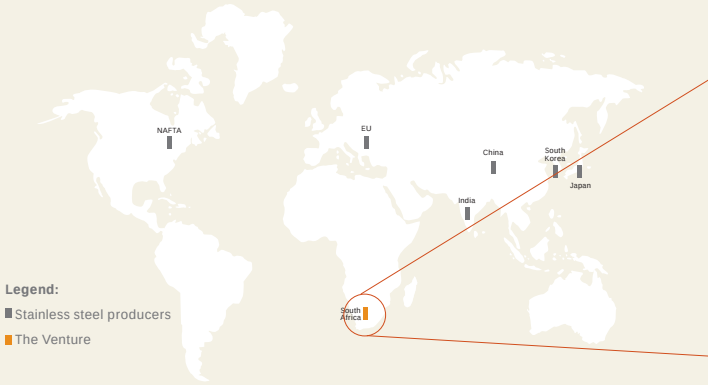
The Venture's global **position**

Elements influencing the **global demand for and pricing of ferrochrome**

- Global economic conditions
- Exchange rates
- Production costs
- Stainless steel demand
- Growth of Chinese ferrochrome industry
- Chrome ore exports

±90%
of the ferrochrome produced is used in **stainless steel****

5%
growth rate forecast for **stainless steel**



Looking back at **2012**

Production of ferrochrome+

±36%	China
±32%	South Africa
±12%	Kazakhstan
±10%	India
±10%	Others (Brazil, EU, Russia, Turkey, Albania, Zimbabwe, etc)

Production of stainless steel+

±45%	China
±21%	EU
±9%	South Korea/Taiwan
±9%	Japan
±7%	India
±6%	NAFTA*

Ferrochrome consumption+

±49%	China
±18%	EU
±13%	South Korea/Taiwan/India
±7%	Japan
±5%	NAFTA*

Consumption of stainless steel**

±38%	China
±19%	EU
±13%	South Korea/Taiwan
±9%	India
±10%	NAFTA*
±8%	Japan

+ *Source of data: Heinz Pariser/February 2013*
* *North American Free Trade Agreement partners – USA, Canada and Mexico*
** *Source: International Chromium Development Association (ICDA)*

For a more detailed breakdown of ferrochrome production and demand see pages 16 to 23



The Venture's position in South Africa

The Venture's competitive advantage

Lowest cost producer in South Africa

Largest ferrochrome producer in the world

Chrome resources in excess of **100 years**

Variety of technologies provide **flexibility**

Major focus on **energy efficiency = major investments** in Phases I and II of the Lion ferrochrome plant and two new pelletising and sintering plants

Lion I and Bokamoso pelletising and sintering plant contributed to overall saving in energy consumption of **more than 12% per tonne of alloy produced**

Newly-constructed Tswelopele pelletising and sintering plant and Lion II will further **increase these savings**

South African chrome industry

Facts

±48%
of China's chrome ore imports in 2012

±35%
of the world's ferrochrome production

±72%
of chrome ore reserves

±R42 billion
contribution to GDP per annum

±R36 billion
in forex earnings per annum

±200 000
direct and indirect jobs

Industry challenges

Increasing electricity costs – **more than doubled** since 2007

Increasing labour **costs** and labour unrest adversely affecting industry

Chrome ore **exports** to China

Socio-political environment
- Labour unrest in mining industry
- Uncertainty around proposed government legislation

See the Mineral Reserves and Resources statement on pages 50 to 61 of this report for details of our chrome resources

MATERIAL ISSUES

Our most material issues

In order to make informed decisions and take appropriate action Merafe and its stakeholders need to identify the issues material to the sustainability of our business. The stakeholders that could be affected by these issues include our employees, shareholders, our partners in the Xstrata-Merafe Chrome Venture (the Venture), the Venture's employees, trade unions, the communities in which the Venture operates, government at local, provincial and national level (in particular the Department of Mineral Resources (DMR) and the South African Revenue Services (SARS)).

We determined our material issues at board and executive level workshops during which we considered financial and non-financial information, the issues driving our sustainability and their possible impact on Merafe and its stakeholders.

	Issue	Stakeholders that could be impacted by or have an impact on this issue	Possible impact	Our mitigating actions/opportunities this issue creates for the business and our response
	Global economic environment	• Shareholders • Merafe management • Merafe employees • Venture partners • Venture communities	• Positive/negative impact on demand for ferrochrome • Positive/negative impact on profitability • Depending on the state of the global economy and demand for ferrochrome and chrome ore, whether the volatility of the rand/dollar exchange rate and the ferrochrome price are in our favour or otherwise, will have a positive or negative impact on all our stakeholders	• While we cannot influence the rand/dollar exchange rate or the global economy and market demand dictates the price of ferrochrome, the Venture can take action to contain costs and remain as competitive as possible. Our investment in the Tswelopele pelletising and sintering plant and Phase II of the Lion ferrochrome plant is increasing the energy efficiency of the Venture's operations and helping to contain costs. The Venture has also managed to reduce the cost of the reductants used in its furnaces and is always looking for and finding ways to further reduce costs
	Diversification – exposure to one commodity	• Shareholders • Merafe management • Merafe employees	• Diversification into other commodities would provide us with a buffer against the cyclical nature of ferrochrome which can and has negatively impacted our profitability during certain years	• Diversification strategy approved by the board • Use empowerment credentials to seek diversification transactions which will enhance shareholder value and smoother returns



Merafe icon
This represents any communication relating to Merafe only



Venture icon
This represents any communication relating to the Xstrata-Merafe Chrome Venture

	Issue	Stakeholders that could be impacted by or have an impact on this issue	Possible impact	Our mitigating actions/opportunities this issue creates for the business and our response
	Partnership in which we do not have a majority stake	• Shareholders • Employees	• Not in control of our destiny • Decisions taken in the best interest of the Venture may negatively impact Merafe	• Contractual provisions • Increase participation interest • Partner with world class operator and global ferrochrome leader • Benefit from economies of scale
	Empowerment credentials	• Shareholders • Venture partners • Employees	• Loss of empowerment credentials would mean loss of competitive advantage and would affect empowerment status of the Venture and diversification opportunities	• Engaging with our key empowerment shareholders • Strategies to increase our empowerment credentials • Opportunity to be an empowerment partner of choice
	Safety, health and wellbeing of Merafe's employees and the Venture's employees and contractors	• Employees, contractors and their families • DMR – Mine Health and Safety Inspectorate • Investors • Trade unions	• Loss of skilled employees • Loss of production impacting on profitability • Negative impact on employee morale • Reputational damage	• The Venture invests in safety training and efforts to transform its safety culture into one where every employee takes responsibility for their safety and that of their fellow employees
	Industrial action in the mining industry and in particular in the operations of the Xstrata-Merafe Chrome Venture	• Venture employees and their families • Trade unions • Shareholders • Communities • DMR	• Loss of production impacting on profitability • Increased costs • Breakdown in relationship with Venture employees • Intimidation of employees by strikers • Damage to property • The safety of the Venture's employees	• The Venture uses every opportunity to engage with its employees, to listen to them, provide them with honest communication regarding the issues that affect them and establish a mutual understanding. It also invests time and effort in establishing an understanding with the trade unions • The Venture also abides by the collective agreements in place and negotiates with the unions annually with the aim of reaching agreement on annual wage increases



In respect of Merafe's empowerment credentials our black ownership of 29% relates to the shareholding of Royal Bafokeng Resources Holdings. The true percentage could be higher as the black ownership of the SA free float (see page 3) has not been determined

MATERIAL ISSUES (continued)

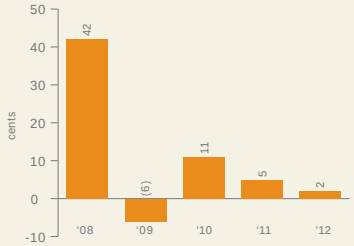
	Issue	Stakeholders that could be impacted by or have an impact on this issue	Possible impact	Our mitigating actions/opportunities this issue creates for the business and our response
	Our social licence to operate	• Communities • Investors • DMR • Employees • Local municipalities	• Dissatisfied communities embarking on action to remove the Venture's social licence to operate • Reputational damage	• To resolve community social issues requires goodwill, commitment and leadership from business, communities, local government and the DMR. If this is addressed the South African mining industry can achieve a more sustainable environment for itself and the communities in which it operates
	Project execution	• Shareholders • Venture management • Venture employees • Venture partners • Communities • Lenders • Customers • Providers of debt	• Loss of profitability • Reputational damage	• The Venture's experienced project team has an excellent track record for delivering projects on time and within budget, which was demonstrated this year with the successful completion of the Tswelopele pelletising and sintering plant and the good progress made with the second phase of the Lion ferrochrome plant
	Chrome ore exports to China	• Shareholders • Merafe management • Merafe employees • Venture partners • Venture employees • Venture communities • Government (SARS)	• Ferrochrome sales to China have been reduced as a result of the export of unbeneficiated chrome ore from South Africa, which is facilitating the growth of a ferrochrome industry in China • Decreased profitability	• The Venture and the ferrochrome industry continue to engage with government with the aim of achieving a solution that supports government's beneficiation and job creation strategies and ensures the sustainability of South Africa's ferrochrome producers

	Issue	Stakeholders that could be impacted by or have an impact on this issue	Possible impact	Our mitigating actions/opportunities this issue creates for the business and our response
	Power prices and the availability of power	• Shareholders • Merafe management and employees • Venture management and employees • Venture communities • Venture customers	• Loss of sales if increased costs make our product prices uncompetitive • Loss of production because of power not being available • Unable to grow the Venture's operations because it is unable to secure a power supply for new projects	• The Venture's continued development and application of energy-efficient technology allows it to maintain its position as South Africa's lowest-cost producer of ferrochrome and therefore the most competitive South African producer • The Venture regularly engages with Eskom and has secured power for the Lion II ferrochrome plant
	Climate change	• All stakeholders	Climate change can impact on the Venture in the following ways: • business continuity and profitability • health and safety • environmental aspects • the Venture's operations give rise to a significant quantity of indirect and direct greenhouse gas (GHG) emissions and are also exposed to the potential impacts of climate change resulting from GHGs	• The Venture continually engages with legislators, researchers and industry bodies to track and evaluate the situation and develop an improved awareness of and preparation for the risks associated with climate change • The Venture is taking steps to reduce its carbon footprint. These include the development of energy-efficient technology and research into the use of alternative sources of energy

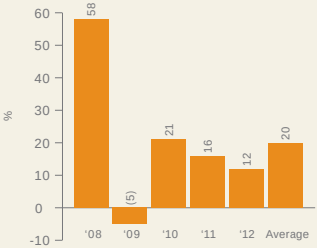
Overview

HISTORICAL REVIEW OF KEY INDICATORS

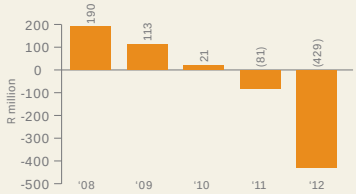
Basic earnings per share



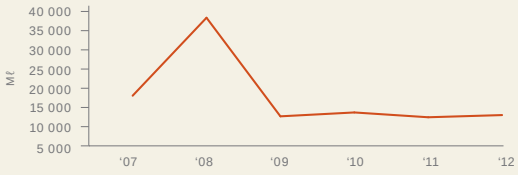
EBITDA margin on revenue



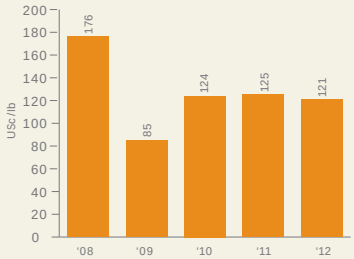
Net cash/(debt) – excluding finance leases



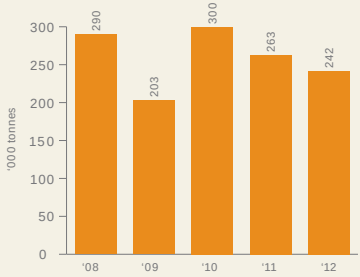
Water usage



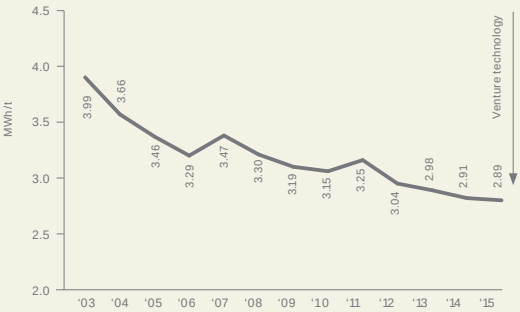
Average European benchmark ferrochrome price



Attributable production tonnes



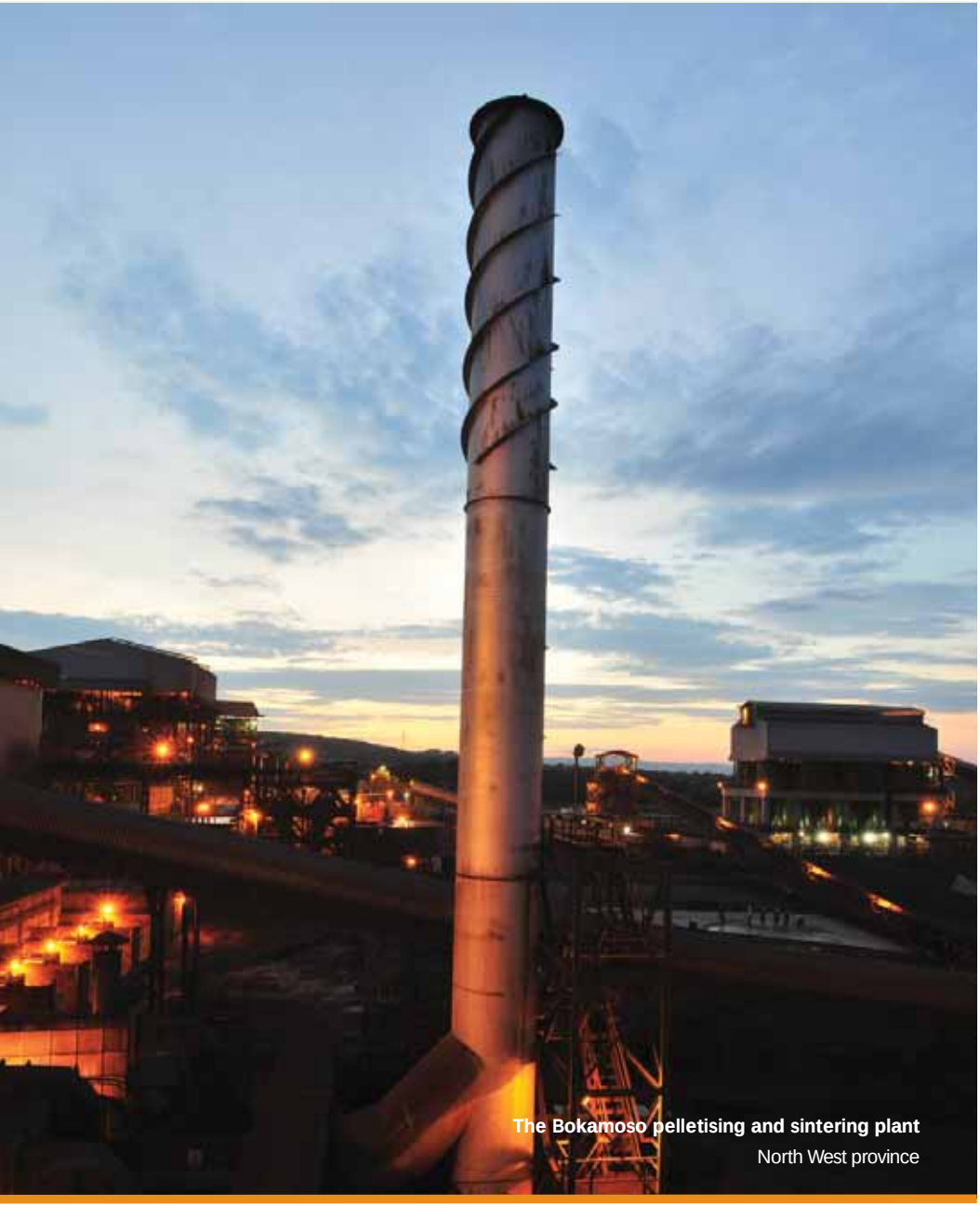
Energy efficiency improvements



This improvement represents more than 25% in energy efficiency over the past decade. The increase in energy consumption in 2007 – 2008 was as a result of reduced pellet availability when all the furnaces operated to meet increased demand.

Safety statistics

	2012	2011	2010	2009	2008
Fatality frequency rate (FFR)	0.00	0.08	0.05	0.05	0.04
Total recordable injury frequency rate (TRIFR)	4.05	3.90	4.58	4.64	5.36



The Bokamoso pelletising and sintering plant
North West province