

Price forecasts upgraded

We have reviewed and raised our price forecasts across the board this month as the base metals outperformed in December and ultimately started 2010 at a higher level than previously expected. The start of the new year and the new decade has seen money continue to flow into commodities while risk appetite has also increased amid plentiful liquidity and optimism over the ongoing recovery in the global economy.

Fundamentally, we are forecasting much tighter supply-demand balances for the base metals this year and next year, which should support further upside to prices going forward. There are still risks however, with arguably the largest being concerns about China curbing spending, the over-reliance on stimulus measures for growth, and fluctuations in the currency markets.

Clearly investment demand is still strong at the moment however, and this remains the main driving force benefiting the metals. Towards the end of this year however, we expect the fundamentals to start reasserting themselves, which may result in the base metals beginning to behave more individually in the medium term.

Our **aluminium** price forecasts rise this month by \$110 to \$2,320/tonne for 2010 and by \$40 to \$2,510/tonne for 2011, on the back of robust investor demand but also on rising smelting costs.

For **copper**, we now have an average of \$7,375/tonne in 2010, with a peak in Q2 and slight moderation in prices into the year-end. Our 2011 forecast remains unchanged at \$7,900/tonne.

Lead has matched the rally in copper since the start of 2009 virtually stride for stride, however, we are starting to see more bearish risks to the lead market outlook in the medium term. This may see the price gains in lead slow somewhat, but we nevertheless expect the underlying uptrend to remain intact overall.

Zinc is likely to continue following copper to a degree, but this market is comparatively well stocked and producers have the tendency to lack discipline. Nevertheless, we still see zinc getting fundamentally tighter in the coming years, although this is more likely to be felt in 2011, with 2010 being more of a transitional year for zinc.

Our **nickel** forecast for 2010 goes from \$18,150/tonne to \$18,875/tonne, with Q4 expected to be the strongest period as it is not until later in the year that we expect to see restocking in the stainless steel industry start to pick up significantly.

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LME Cash Price Analysis and Forecasts

\$/tonne	Dec 09	Ytd Range	Actual Prices			Forecasts	
			2007	2008	2009	2010	2011
Aluminium	2,180	1254 - 2,307	2,639	2,576	1665	2,320	2,510
Copper	6,982	3,051 - 7,594	7,126	6,969	5,150	7,375	7,900
Lead	2,330	992 - 2,591	2,595	2,090	1,661	2,420	2,450
Nickel	17,066	9,405 - 21,070	37,181	21,074	14,272	18,875	22,300
Tin	15,547	10,055 - 17,680	14,536	18,539	13,402	17,300	20,200
Zinc	2,376	1,060 - 2,635	3,250	1,873	1,612	2,330	2,550
Aluminium Alloy	1,902	1,011 - 2,021	2,192	2,375	1,462	1,800	1,980
NASAAC	2,038	902 - 2,155	2,183	2,384	1,447	1,900	2,090

Economic trends

Recovery to date has not been without risks...

China and, to a lesser extent, India were the star performers among the world's largest economies in 2009. While monetary and fiscal policies succeeded in putting a floor under GDP growth in both cases, these actions have brought their own risks, namely asset bubbles and inflation. Wholesale price inflation is now approaching an 11-year high of almost 20% in India, while the quality of much of the current surge of investment in China is questionable and could ultimately result in a debt crisis similar to that which has plagued the US residential housing market.

...and these remain a concern going into 2010

In developed markets, the risks to growth remain primarily deflationary. This is particularly the case in Japan, where consumer prices have now fallen for nine straight months and income growth is weak. Ultra-low interest rates mean that the BoJ and other central banks have little room left for manoeuvre, particularly as most have signalled their intention to begin winding down quantitative easing this year.

Slow recovery expected to continue

Nonetheless, such indicators as industrial production and unemployment rates suggest that economies like the US, Germany and Japan are likely to have continued to grow during Q4. However, there is unlikely to have been a significant acceleration from the previous quarter.

That said, a double-dip recession remains a risk in Europe and Japan, while housing market woes in the US may not yet have completely played out. This may continue to weigh down the US economy's still-fragile consumer confidence.

US IP continues to rebound

Having been stable in October, US industrial output grew by 0.8% month-on-month in November, with manufacturing output increasing by 1.1%. Capacity utilization rose by 0.7 percentage points, to 71.3%. However, this was still 9.6 percentage points below its 1972-2008 average. Nevertheless, another strong month for the ISM index in December, suggests that the recovery in IP would have continued last month and we expect momentum to roll into 2010 too.

EU IP falls on weak consumer non-durables...

Having risen by 0.1% month-on-month in September, EU27 IP fell by 0.7% in October. In year-on-year terms, it fell by 10.2%, an improvement of 2 percentage points on the pre-

vious month. Weakness has recently been concentrated in capital and intermediate goods, but the main fall in October was in non-durable consumer goods.

...exports up, but retail sales weak...

This weakness in EU consumption is also reflected in trade data, where Eurozone exports rose significantly over the period May-October, while imports were broadly stable. Meanwhile, seasonally adjusted retail trade volumes were down by 1.9% year-on-year in October (versus a 2.8% fall in September), the 12th straight month of decline. However, German retail volumes rose by 0.5%, their first gain in three months, while the UK figure rose for a second consecutive month.

...construction stable, autos recovering

The rate of decline in construction sector activity in the EU is easing, improving from -7.7% to -6.9% year-on-year in October. There is a sharp division between western and eastern Europe in this regard, with construction output down by over a fifth in such markets as Romania, Bulgaria and the Baltic countries, while it is down by just over 5% in the UK and France and stable in Germany.

Having suffered a precipitous decline during the earlier part of the year, new car registrations in Europe grew by 26.6% year-on-year in November. This is largely reflective of fleet renewal schemes in a number of Western European markets, particularly Germany and France, so it may be difficult to sustain.

Chinese industrial output booms...

Growth in the value added of Chinese industry accelerated sharply between September and October, rising from 16.1% to 19.2% year-on-year, with the heavy industrial sector expanding by 22.2% and light industry by 12.6%. Metals are at the leading edge of this surge: The value added derived from the manufacture and processing of ferrous and non-ferrous metals rose by 27.1% and 28.8%, respectively, in October.

...as does investment, led by the public sector...

Investment in fixed assets grew by 32.1% during the first 11 months of 2009, with investment in primary industry surging by 51.5%. Unlike the increase in output, which is largely being driven by the private sector, much of this surge in investment is government related: Investment in state-owned and state-controlled enterprises expanded by 37.8%. According to one leading banking regulator, China has targeted 17% growth in broad M2 money supply in 2010, the same as 2009's target but significantly below its actual growth of 30%.

Aluminium — Price outlook raised on rising smelting costs, investor demand

Strong risk appetite and abundant liquidity has continued to see investors divert money into commodities, helping aluminium prices start the year on a strong footing.

At 2,300/tonne, prices have recovered 78% from their lowest point in February 2009, though we note that this is only around half the gain achieved by copper and lead.

Fundamentally, cost drivers are back on the agenda for aluminium with positive industrial production around the world helping to drive energy prices higher. Rising energy prices are likely to continue to boost sentiment towards the metal, and lend background support to prices.

This, together with ongoing investor demand for commodities in general and a warming to aluminium in particular, has led us to revise our 2010 price forecast slightly higher this month. It rises to \$2,320/tonne from \$2,210/tonne previously, while 2011 goes up by \$40 to \$2,510/tonne.

Smelting costs are back on the agenda...

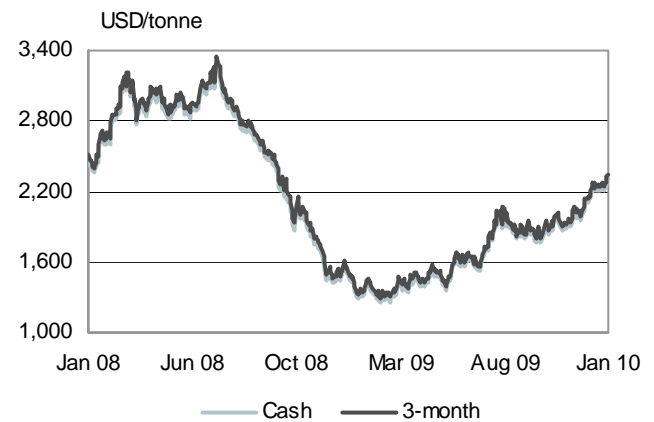
One of the main effects of the recession, besides the collapse in demand, was the strong correction in energy costs. Now, as industrial production starts to show signs of recovery, energy costs are also seeing upward pressure. With energy representing 30-40% of the cost of producing primary aluminium, higher electricity tariffs will lift the economic floor for the aluminium price.

Energy prices are still well below the peaks of 2008, but electricity tariffs in most major aluminium producing regions such as China and Europe are starting to increase. In China, a combination of higher electricity demand from industrial consumers, and higher fuel costs, prompted the government to adjust electricity tariffs upwards in December. More recently, the cold snap has been adding pressure to energy costs and energy availability.

...and not just energy

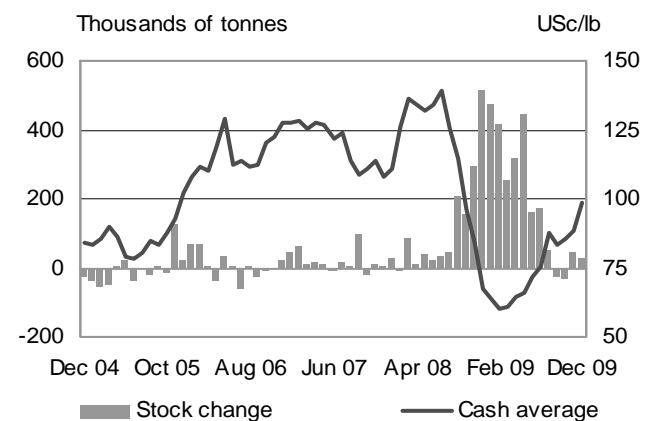
Other smelting costs are also back on the agenda. As aluminium smelters restart capacity (Chalco announced that is restarting all its idled operations) and as new greenfield projects come on stream in China and the Middle East (Qatar and Emal), carbon costs are likely to increase as well. In China carbon costs have been increasing since the last quarter of 2009 and are expected to continue rising through 2010. In other regions of the world, suppliers and smelters are currently busy negotiating the price for delivery during the first half of the year, with this trend also likely to be an upwards one.

LME cash and 3-month aluminium price



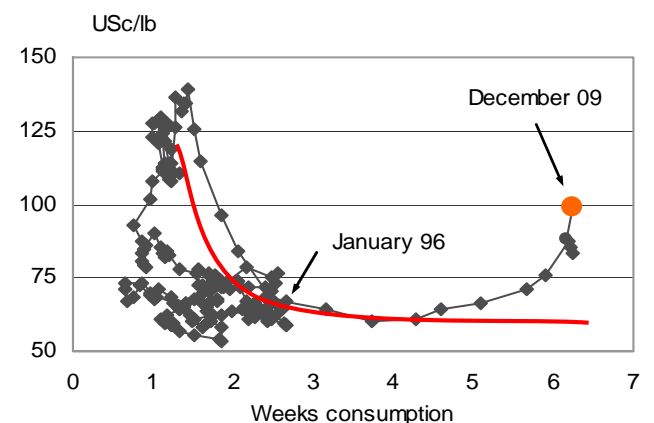
Sources: LME; Standard CIB Research

Monthly change to LME aluminium stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME aluminium stocks vs. cash price



Sources: LME; Standard CIB Research

Short term supply issues not exclusive to copper

Supply side events in the aluminium market have been dominated by the commissioning of new greenfield projects in Qatar and Abu Dhabi, and the restart of idled Chinese capacity.

More recently, we have had some supply issues that are likely to reduce production, at least in the short term.

- **Venezuela** may be forced to close the two aluminium smelters operating in the country due an electricity rationing programme imposed by the government, after the Guri reservoir reached critically low water levels.
- In **Brazil**, power constraints are also affecting aluminium production.
- Meanwhile, in **southern Africa** a chronic electricity

generation gap is still overhanging the market and continues to threaten the viability of the smelters in the region.

- In **Europe**, the threat to aluminium smelters is also related to power and may have long term implications too, with the viability of significant capacity looking questionable without competitive long term electricity contracts. Longer term, it looks like aluminium producers in the region will relocate their European operations to other parts of the world. This is already happening in some cases, with Hydro closing capacity in Germany and commissioning capacity in Qatar. Similarly, Alcoa, which is threatening to close its Italian operations if they fail to agree a competitive power deal, has meanwhile announced plans to invest in an aluminium complex in Saudi Arabia which includes a 740,000 tpy smelter.

Annual Global Supply/Demand Balance for Aluminium, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Production											
Africa	1,369	1,372	1,428	1,711	1,752	1,864	1,815	1,715	1,688	1,884	1,854
North America	5,222	5,415	5,495	5,109	5,375	5,332	5,642	5,783	4,850	4,620	4,523
Latin America	1,991	2,229	2,275	2,356	2,391	2,493	2,559	2,660	2,536	2,588	2,714
Asia (ex. China)	2,099	2,113	2,317	2,585	2,944	3,296	3,504	3,700	4,239	4,850	5,995
Western Europe	4,196	4,260	4,425	4,667	4,741	4,541	4,664	4,840	3,862	3,666	3,383
Australasia	2,121	2,170	2,198	2,246	2,252	2,274	2,314	2,296	2,175	2,112	2,120
China	3,385	4,420	5,465	6,589	7,743	9,349	12,607	13,129	13,550	14,895	16,600
CIS and Eastern Europe	4,049	4,141	4,345	4,569	4,643	4,749	5,021	5,182	4,583	4,473	4,460
Total	24,432	26,120	27,948	29,831	31,840	33,898	38,126	39,305	37,482	39,088	41,649
Year-on-year %change	0.0%	6.9%	7.0%	6.7%	6.7%	6.5%	12.5%	3.1%	(4.6%)	4.3%	6.6%
Consumption											
North America	6,251	6,595	6,829	7,500	7,567	7,653	7,526	6,913	5,043	5,446	5,712
Asia (ex. China)	5,304	5,473	6,001	6,646	6,780	6,960	7,100	7,140	6,675	7,020	7,240
Western Europe	5,720	6,038	6,192	6,603	6,717	7,055	7,244	7,256	5,900	6,074	6,403
China	3,599	4,189	5,148	6,086	7,091	8,480	11,497	12,934	14,100	15,720	17,800
Others	3,202	3,243	3,408	3,637	3,855	4,098	4,187	4,288	4,065	4,191	4,643
Total	24,075	25,538	27,577	30,473	32,009	34,246	37,554	38,531	35,784	38,451	41,541
Year-on-year %change	(3.3%)	6.1%	8.0%	10.5%	5.0%	7.0%	9.7%	2.6%	(7.1%)	7.5%	8.0%
Implied surplus (deficit)	357	581	371	(641)	(169)	(348)	571	773	1,699	637	109
Stocks analysis											
IAI	1,740	1,660	1,629	1,788	1,797	1,621	1,553	1,676			
LME	821	1,241	1,423	693	644	698	929	1,338			
COMEX	270	340	213	61	160	122	40	35			
SHFE	34	11	27	60	46	19	89	207			
Total	3,873	4,455	4,826	4,184	4,016	3,667	4,239	5,012	6,711	7,348	7,457
Stocks as weeks of consumption	8.4	9.1	9.1	7.2	6.5	5.6	5.9	6.8	9.8	9.9	9.3
LME cash prices											
Historical & base case (\$/tonn	\$1,443	\$1,350	\$1,431	\$1,716	\$1,898	\$2,567	\$2,639	\$2,576	\$1,665	\$2,320	\$2,510
(cents/lb)	65.5c	61.2c	64.9c	77.8c	86.1c	116.4c	119.7c	116.8c	75.5c	105.2c	113.9c

Sources: IAI; WBMS; LME; COMEX; SHFE; Standard CIB Research

Aluminium alloy

With no clear fundamental changes in the market of automotive grade aluminium alloy, the LME alloy contract mostly tracked the price of primary aluminium during the run in to the year-end and through January thus far.

That said, in the physical market for the alloy in Europe, demand from diecasters has improved over the past month or two, while smelting cost pressures have also increased on the back of recent tightness in the silicon metal market.

The price of silicon metal was at \$1,800/tonne CIF Japan in November, but has been rising on a daily basis since the beginning of December. We understand that silicon is currently trading at \$2,200/tonne CIF Japan and is likely to continue to increase further during the first few months of 2010. The droughts in China and the cold snap in the northern hemisphere will likely continue to exacerbate the upward pressure, at least until spring.

All in all, the aluminium alloy contract is trading at around a 14% discount to primary, which is a higher discount than the 9-10% discount observed during Q4 2009, but lower than that of Q1 2009 when the contract traded at an average discount of 17% over the primary contract.

Meanwhile LME stocks stopped their declining trend by mid December, with LME warehouses even receiving some net inflows just before Christmas. Given their timing, we would not read too much into these deliveries as, in our view, they are likely to be associated with stock management and year-end accounting rather than indicating a significant deterioration in the market.

NASAAC

A combination of good demand from the automotive sector and an almost chronic tightness in the scrap market in North America has driven NASAAC prices higher in December and during the first week of the new year. The contract closed at \$2,115/tonne on Friday, after having reached as high as \$2,190/tonne the day before.

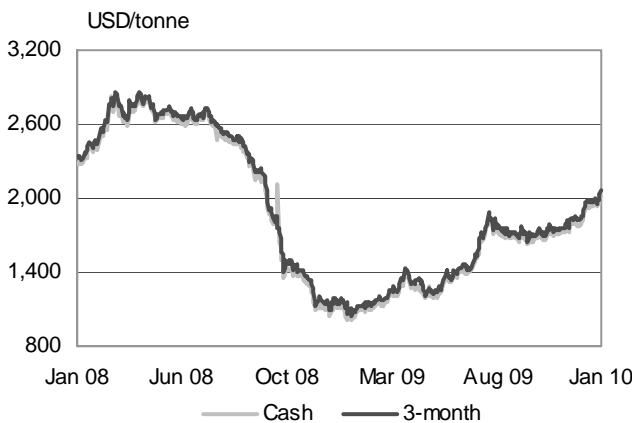
The NASAAC contract is currently trading at around an 8% discount to primary aluminium, which is slightly higher than the 6-7% discount observed during Q4 2009, but substantially lower than that of Q1 2009 when it traded at an average 25% discount to primary.

LME inventories of the North American alloy, which had been falling consistently during the last part of 2009, are likely to remain on this trend. However, we understand that diecasters are starting to find that sourcing material from warehouses is less convenient than it had been during previous months, and they are now willing to rely more on the physical spot market.

As noted previously, the scrap situation remains tight, and was one of the most important factors during 2009 driving NASAAC prices. However, it is unclear whether the current tightness is a continuation of the trend seen during most of last year, or due to seasonal factors now; as scrap is usually tight at the beginning of the year.

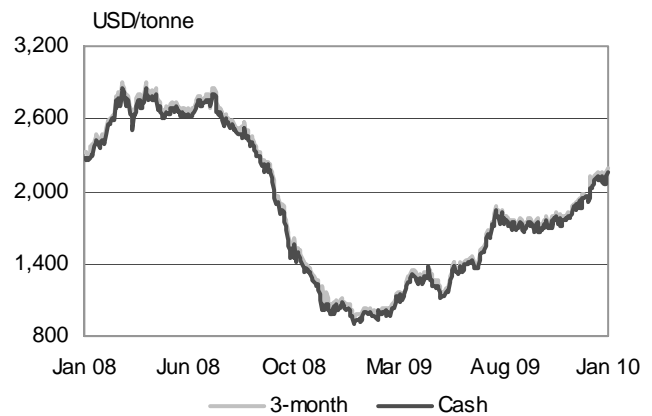
We understand that although scrap availability is currently still rather constricted, it is likely to improve going forward as material generated through the cash for clunkers scheme works its way into the system.

LME cash and 3-month aluminium alloy price



Sources: LME; Standard CIB Research

LME cash and 3-month NASAAC price



Sources: LME; Standard CIB Research

Copper — Shanghai arbitrage open again

Copper prices rallied surprisingly strongly either side of the New Year. With the SHFE outperforming the LME's rise past \$7,600/tonne, arbitrage opportunities between the two markets have opened up again and imports into China have picked up. Although premiums have increased, spot demand in the physical market is subdued and is likely to remain so until after the Chinese New Year in February.

However, we still expect a robust year in terms of Chinese copper consumption as stimulus measures continue to fuel internal demand and as China's export sector starts to benefit from recovering demand from Western consumers.

We have made revisions to both our supply and demand forecasts this month, but our balance has barely changed, continuing to show a small surplus this year and a deficit in 2011.

Given the higher-than-expected level that prices have started this year, and the fact that a tighter market is in store fundamentally, we have nudged our price forecasts up again this month. We now have an average of \$7,375/tonne in 2010, with a peak in Q2 and slight moderation in prices into the year-end. However, we expect the overall broad upwards trend to remain intact, so keep our 2011 forecast unchanged at \$7,900/tonne.

View on Chinese copper output raised

Chinese refined copper production has surprised on the upside in recent months. We had expected a tight spot concentrate market to limit growth more than it has. Improved availability of scrap, at least compared with the very tight market at the start of the year, has been a key factor in keeping smelter production elevated.

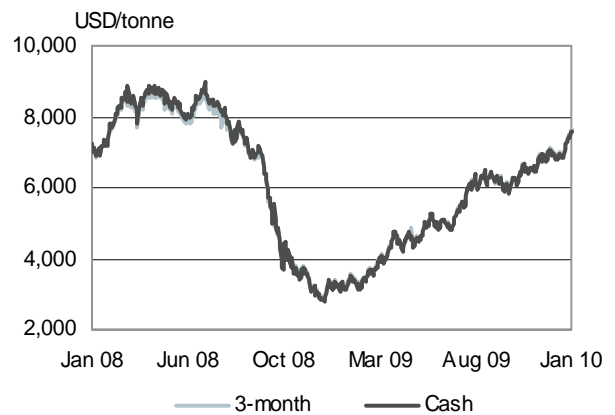
We have raised our figure for Chinese output in 2009 to 4.20m tonnes from 3.95m tonnes previously. We have upgraded our forecasts for 2010 and 2011 accordingly, keeping growth at around 4%. This is well below the average annual growth rate for the past decade, of 13.7% a year, but is realistic in light of the fact that the global concentrate market that looks set to get even tighter with mine production growth forecast at only around 2%.

Consumption forecasts adjusted

We have reviewed our consumption forecasts and made a number of revisions.

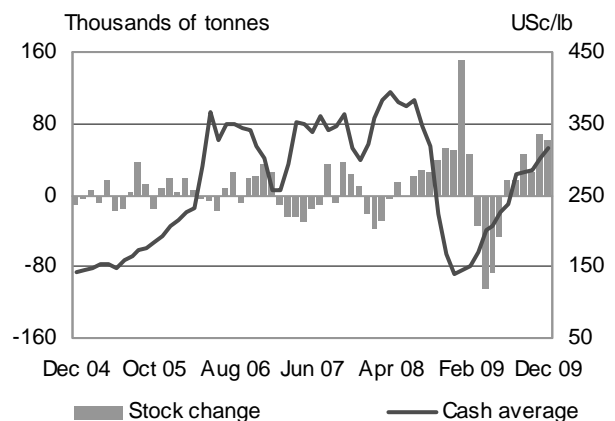
- **Chinese consumption estimates have been raised for 2009.** Although apparent demand for refined copper jumped 37% last year (boosted by stock building and scrap shortages in H1), copper semis output grew

LME cash and 3-month copper price



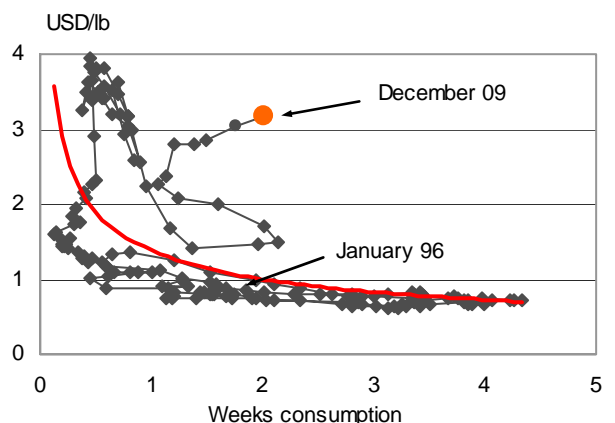
Sources: LME; Standard CIB Research

Monthly change to LME copper stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME copper stocks vs. cash price



Sources: LME; Standard CIB Research

by 16.7% in the year to November, so growth of around 15% seems reasonable for real consumption of refined copper.

- Currently we do not expect to see the same level of Chinese apparent demand growth in 2010 as we saw in 2009. Our 2010 and 2011 consumption forecasts remained unchanged at what we consider to be a realistically bullish growth rate of 8-9%.
- **We have revised down our outlook for European copper consumption.** We are modelling growth of just 1.5% in 2010 and 2% in 2011, having also revised down our 2009 estimates to show a double-

digit contraction last year. Europe's recovery looks increasingly hindered and we expect growth to lag North America in the coming years

- **We have maintained our Asian growth forecasts** as they were already factoring fairly robust growth in copper consumption, led by emerging economies, such as India. Japan's recovery continues in line with expectations, with the latest data showing that output of copper and brass semi-fabricated products continues its v-shaped recovery, and is now more than double the low seen in March 2009.

Annual Global Supply/Demand Balance for Copper, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mine production											
Total	13,626	13,578	13,785	14,607	14,921	15,020	15,580	15,440	15,240	15,580	16,000
Year-on-year % change	3.1%	(0.4%)	15%	6.0%	2.1%	0.7%	3.7%	(0.9%)	(1.3%)	2.2%	2.7%
Refined production											
Africa	413	447	454	508	513	563	627	680	770	860	950
North America	2,793	2,326	2,074	2,198	2,162	2,155	2,175	2,210	2,060	2,080	2,100
Latin America	3,595	3,564	3,608	3,566	3,549	3,553	3,595	3,535	3,600	3,660	3,770
Asia (ex. China)	3,362	3,358	3,489	3,541	3,831	4,200	4,330	4,340	4,030	4,100	4,200
China	1,510	1,613	1,836	2,199	2,600	3,047	3,497	3,779	4,200	4,368	4,543
Australasia	560	543	484	490	469	429	442	502	480	505	518
Europe	3,411	3,420	3,309	3,449	3,533	3,605	3,620	3,710	3,560	3,610	3,700
Total	15,644	15,271	15,254	15,951	16,657	17,552	18,286	18,756	18,700	19,183	19,781
Year-on-year % change	5.5%	(2.4%)	(0.1%)	4.6%	4.4%	5.4%	4.2%	2.6%	(0.3%)	2.6%	3.1%
Refined consumption											
North America	3,310	2,971	2,900	3,101	2,967	2,863	2,805	2,720	2,610	2,690	2,750
Latin America	533	432	494	541	552	554	568	580	560	580	610
Asia (ex. China)	3,864	4,196	4,216	4,564	4,522	4,680	4,900	4,860	4,500	4,700	4,935
China	2,357	2,774	3,097	3,371	3,540	3,820	4,525	4,930	5,670	6,124	6,675
Europe	4,732	4,651	4,754	5,031	4,814	5,208	5,155	5,050	4,545	4,613	4,705
Others	295	337	332	333	355	343	350	352	340	351	360
Total	15,090	15,361	15,793	16,941	16,750	17,468	18,303	18,492	18,225	19,058	20,035
Year-on-year % change	(18%)	1.8%	2.8%	7.3%	(1.1%)	4.3%	4.8%	1.0%	(1.4%)	4.6%	5.1%
Implied surplus (deficit)	554	(90)	(539)	(990)	(93)	84	(17)	264	475	125	(255)
Stocks analysis											
LME	799	856	431	49	92	191	199	341			
COMEX	244	362	255	44	6	31	14	31			
SHFE	94	75	121	32	58	31	26	15			
Producer	290	240	238	233	238	283	259	256			
Merchant	27	19	23	20	17	18	21	26			
Consumer	181	161	145	141	135	149	154	135			
Total	1,636	1,712	1,212	519	546	703	673	804	1,279	1,404	1,150
Stocks as weeks of consumption	5.6	5.8	4.0	1.6	1.7	2.1	1.9	2.3	3.6	3.8	3.0
LME cash prices											
Historical & base case (\$/tonn	\$1,577	\$1,558	\$1,780	\$2,866	\$3,684	\$6,730	\$7,126	\$6,969	\$5,150	\$7,375	\$7,900
(cents/lb)	71.5c	70.7c	80.7c	130.0c	167.1c	305.3c	323.2c	316.1c	233.6c	334.5c	358.3c

Sources: ICSG; WBMS; LME; COMEX; SHFE; Standard CIB Research

Lead — In the shadow of copper

Lead has matched the rally in copper since the start of 2009 virtually stride for stride, with both metals ending the year essentially neck-and-neck as the complex's top performers with annual gains of 150%.

This is unsurprising since they both have the lowest LME stock levels in terms of weeks of consumption and are both highly prone to supply disruptions. Furthermore, like copper, we see the lead market being very close to balance this year and believe a deficit is likely in 2011.

However, we are starting to see more bearish risks to the lead market outlook in the medium term, as Chinese output continues to grow very rapidly and demand growth matures. This may see the price gains in lead slow somewhat, but we nevertheless expect the underlying uptrend to remain intact overall.

Our upwardly-revised price forecast for 2010 is \$2,420/tonne, which represents a 40% increase from last year's annual average price. The increase we expect to see for copper is 43%.

China a net exporter again

While China remains a net importer of all other base metals, it resumed net exporter status for lead in November. Exports exceeded imports, albeit by less than 1,000 tonnes, for the first time since mid-2008. This is not a surprise, particularly given the surplus of metal available after the massive spike in imports in the first half of the year, and the record high levels of domestic production achieved prior to the pollution-related clampdown in August.

Chinese production reviewed...

It is noteworthy however, that Chinese smelter production has started to fall back a little further now, with the latest official CNIA data for November putting output at 305,000 tonnes, down 16% from August's peak.

Although severe winter weather has reportedly forced the closure of many lead-zinc mines in Inner Mongolia – a region that accounts for up to 20% of domestic concentrate supply – we note that winter disruptions are fairly common and we do not think we need to lower our supply expectations for 2010 on this news.

...risks are to the upside

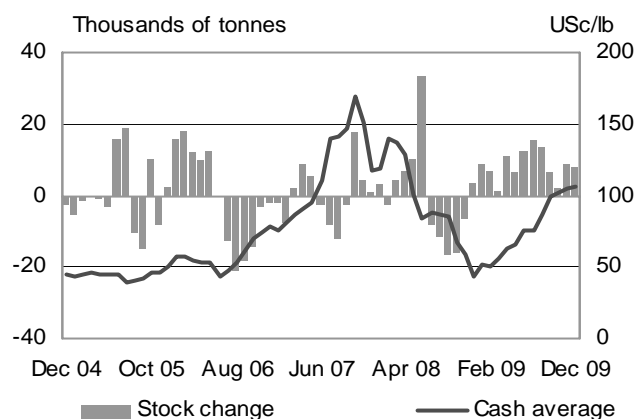
In fact, we believe the risk to our Chinese lead production forecasts are to the upside, as more than 1m tpy of new smelting capacity that was under construction in 2009 is

LME cash and 3-month lead price



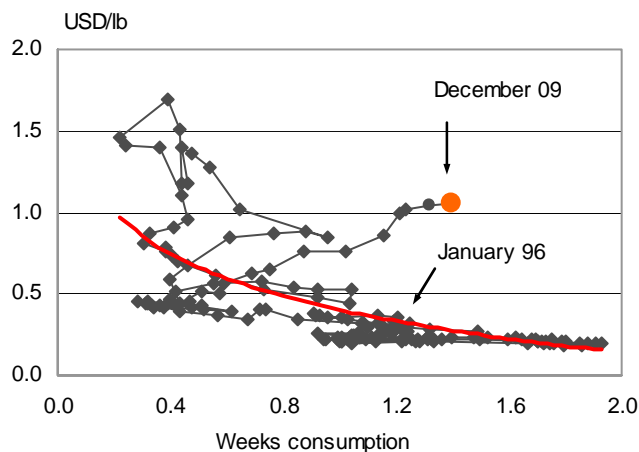
Sources: LME; Standard CIB Research

Monthly change to LME lead stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME lead stocks vs. cash price



Sources: LME; Standard CIB Research

scheduled to come on stream this year and next. Much of it is secondary capacity commissioned to recycle the massive pool of vehicle batteries now in circulation in the world's largest auto and e-bike market.

So, although it may not be until March that Chinese refined lead production starts accelerating again, we still think 2010 will be another year of double-digit growth following a 17% annual increase in 2009. We have revised our Chinese supply forecasts upwards accordingly.

E-bike legislation changes

On the demand side, new legislation in China may have bearish implications for lead demand. Until now, the electric bike market has been booming, as it provides a cheap and

easily accessible form of motorized transport for millions of rural and urban Chinese. In a short space of time, the market has ballooned to the point where around 25m e-bikes are sold in China annually, each requiring a lead-acid battery containing on average around 10kg of lead and requiring replacement annually. However, China has reclassified e-bikes weighing more than 40kg or running faster than 20kph as electric motorbikes, which would require a driving licence and insurance.

The concern is that these tighter requirements may cool down consumer enthusiasm for e-bikes. We would not be in a rush to reach this conclusion ourselves yet, but would acknowledge that it is a downside risk to the lead demand outlook that we had not previously allowed for.

Annual Global Supply/Demand Balance for Lead, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mine production											
Total	3,032	2,831	3,120	3,138	3,437	3,540	3,685	3,890	3,800	3,960	4,150
Year-on-year % change	(0.5%)	(6.6%)	10.2%	0.6%	9.5%	3.0%	4.1%	5.6%	(2.3%)	4.2%	4.8%
Refined production											
Africa	132	144	138	100	111	114	90	97	86	98	120
North America	1,866	1,848	1,854	1,745	1,775	1,806	1,802	1,827	1,720	1,780	1,760
Latin America	229	244	238	270	270	266	265	270	180	200	260
Asia (ex. China)	1,014	1,036	1,066	1,058	1,093	1,106	1,152	1,315	1,320	1,350	1,410
China	1,196	1,325	1,564	1,934	2,391	2,715	2,757	3,106	3,622	3,977	4,150
Australasia	280	311	315	281	277	253	252	275	252	260	270
Europe	1,905	1,762	1,589	1,569	1,702	1,655	1,747	1,794	1,670	1,700	1,740
Total	6,622	6,670	6,764	6,957	7,619	7,915	8,065	8,684	8,850	9,365	9,710
Year-on-year % change	(0.3%)	0.7%	14%	2.9%	9.5%	3.9%	1.9%	7.7%	1.9%	5.8%	3.7%
Refined consumption											
North America	2,003	1,861	1,823	1,816	1,891	1,923	1,777	1,848	1,720	1,750	1,790
Latin America	191	205	207	224	237	236	221	241	240	244	250
Asia (ex. China)	1,359	1,458	1,535	1,585	1,533	1,566	1,610	1,620	1,540	1,580	1,643
China	720	957	1,183	1,510	1,973	2,213	2,543	2,890	3,260	3,749	4,199
Europe	2,054	2,027	1,933	2,007	1,998	1,968	1,944	1,855	1,690	1,720	1,740
Others	149	134	153	153	142	145	140	142	140	142	144
Total	6,476	6,642	6,834	7,295	7,774	8,051	8,235	8,596	8,590	9,185	9,766
Year-on-year % change	(0.2%)	2.6%	2.9%	6.7%	6.6%	3.6%	2.3%	4.4%	(0.1%)	6.9%	6.3%
Implied surplus (deficit)	187	34	(10)	(282)	(119)	(117)	(170)	88	260	181	(54)
Stocks analysis											
LME	98	184	109	40	44	41	45	45			
Producer	188	142	138	127	145	137	97	114			
Consumer	149	156	159	132	118	130	138	146			
Merchant	1	1	1	1	2	2	2	1			
Total	436	483	407	300	309	310	282	306	566	746	692
Stocks as weeks of consumption	3.5	3.8	3.1	2.1	2.1	2.0	18	19	3.4	4.2	3.7
LME cash prices											
Historical & base case (\$/tonn	\$476	\$453	\$516	\$887	\$976	\$1,288	\$2,595	\$2,090	\$1,661	\$2,420	\$2,450
(cents/lb)	216c	20.5c	23.4c	40.2c	44.3c	58.4c	117.7c	94.8c	75.3c	109.8c	111.1c

Sources: ILZSG; WBMS; LME; Standard CIB Research

Nickel — 2010 forecast edged higher; 2011 unchanged above \$22,000

Our view on nickel recently has been that supply and demand are closely balanced. This continues to be backed up by INSG data that now shows a market in net deficit since May, due primarily to a combination of recovering demand and stalled supply growth in the wake of the ongoing strike in Canada.

However, it is fair to say that demand has not recovered at the pace we expected and we wait for it to pick up another gear. This may not come until the second half of 2010, as stainless steel mills in the Western World are still not in a position to move into restocking mode. We think hand-to-mouth buying will remain the preference of most mills in the first half of the year.

Furthermore, the relocation of nickel inventories into LME warehouses, which was such a prominent feature of the market in the second half of 2009, should be nearing completion. Stocks may therefore start to level out or even turn lower soon, which will begin to lend a more fundamental element of support to prices.

As with the other metals, we have raised our price forecasts this month. Nickel for 2010 goes from \$18,150/tonne to \$18,875/tonne, with Q4 expected to be the strongest period. For 2011, we are content to keep our price forecasts unchanged at \$22,300/tonne, the higher level being consistent with the first deficit market in five years forecast for that year.

Chinese supply and demand figures revised higher...

It has been the case with many of the base metals that we have needed to revise up both supply and demand for China in 2009. The same is true for nickel. Our figures now show production growth of 21% this year and consumption at 17%. We have also raised our 2010 consumption forecasts to 470,000 tonnes, which means further growth of 12% is expected this year.

...as the stainless market enjoyed a record year

While the Western World stainless steel mills had a woeful year, reducing capacity utilisation to around 50% for much of it, SSC data shows that China's production and consumption of stainless broke records last year. Output reportedly rose 25% to more than 8.6m tonnes, as Shanxi Taigang raised production to 2.4m tonnes from 1.8m tonnes in 2008, making it the largest stainless mill in the world. Apparent demand for stainless steel in China jumped 30% last year to 8.1m tonnes.

Bullish on stainless output in 2010

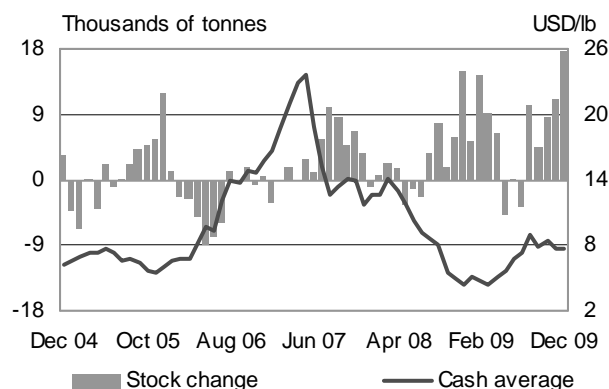
Globally, we see stainless production rebounding by 18% year-on-year in 2010, led by further new capacity additions in China. Growth of 5-7% is our base case for 2011 and 2012. Overall, however, this growth profile should underpin a big bounce in

LME cash and 3-month nickel price



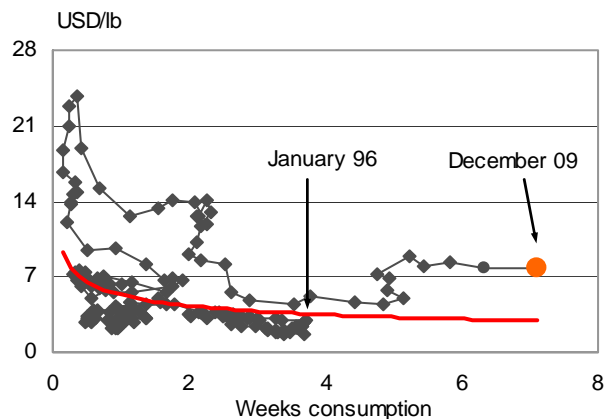
Sources: LME; Standard CIB Research

Monthly change to LME nickel stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME nickel stocks vs. cash price



Sources: LME; Standard CIB Research

nickel consumption, but apparent demand should see an even bigger rise on restocking. The traditional destocking-restocking cycle in the stainless industry makes for large swings in nickel demand, and this cycle should be no different once sufficient credit lines are available to Western mills and balance sheets turn healthier. Accordingly, it may not be until the second half of the year that the restocking drive really takes off in the Western World.

A new era for HPAL nickel projects?

Speculation about the future of BHP Billiton's shuttered Ravensthorpe HPAL nickel mine in Australia was put to rest in December when African-focused copper producer First Quantum announced the acquisition of the operation.

This is a significant development for the nickel market, not

least because it means that our models need to start including output from Ravensthorpe again from as early as next year. But it also means that we may have been too harsh with our low expectations for HPAL projects generally. Interestingly, we understand that First Quantum's due diligence on Ravensthorpe highlighted that the usually-troublesome and complex HPAL technology is sound. The mine's failings were in other areas and First Quantum believes that better sulphuric acid supply risk management, improvements in the plant's crushing facilities, a reduction the contract labour force and cutting annual production from 50,000 tpy to 39,000 tpy is all Ravensthorpe needs to make it a viable operation.

We now await progress on other major HPAL projects being developed currently, particular the ramp up of Goro this year and then the commissioning of Ambatovy.

Annual Global Supply/Demand Balance for Nickel, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mine production											
Total	1,224	1,248	1,264	1,327	1,387	1,503	1,595	1,530	1,380	1,415	1,598
Year-on-year % change	4.3%	19%	13%	5.0%	4.5%	8.4%	6.1%	(4.1%)	(9.8%)	2.5%	12.9%
Refined production											
Africa	53	55	54	57	56	55	50	42	40	45	48
North America	141	145	124	152	140	147	154	168	113	152	167
Latin America	124	146	157	161	168	171	168	137	122	128	146
Asia (ex. China)	164	167	174	177	173	167	180	178	173	185	190
China	50	54	65	73	98	137	219	200	242	250	250
Australasia	174	181	167	166	178	163	156	142	151	158	172
Europe	449	434	451	468	463	512	514	510	446	460	490
Total	1,154	1,181	1,191	1,253	1,276	1,352	1,441	1,377	1,287	1,378	1,463
Year-on-year % change	6.5%	2.3%	0.9%	5.2%	18%	6.0%	6.6%	(4.4%)	(6.5%)	7.1%	6.2%
Refined consumption											
North America	147	133	130	139	148	155	145	137	126	136	140
Latin America	23	27	29	26	26	25	26	24	22	23	25
Asia (ex. China)	353	408	422	430	402	429	380	348	299	345	380
China	88	94	125	150	190	245	330	360	420	470	506
Europe	461	476	461	454	447	492	424	400	333	352	380
Others	33	38	48	46	34	46	41	40	36	41	42
Total	1,104	1,176	1,215	1,245	1,247	1,392	1,346	1,309	1,236	1,367	1,473
Year-on-year % change	(16%)	6.5%	3.3%	2.5%	0.2%	116%	(3.3%)	(2.7%)	(5.6%)	10.6%	7.8%
Implied surplus (deficit)	50	(51)	37	8	29	(40)	95	68	51	11	(9)
Stocks analysis											
LME	19	22	24	21	36	7	48	79			
Producer	74	69	73	72	71	75	70	71			
Consumer and merchant	28	18	22	5	4	6	9	6			
Total	121	109	119	98	111	88	127	156	207	218	209
Stocks as weeks of consumption	5.7	4.8	5.1	4.1	4.6	3.3	4.9	6.2	8.7	8.3	7.4
LME cash prices											
Historical & base case (\$/tonn	\$5,948	\$6,772	\$9,640	\$13,852	\$14,735	\$24,287	\$37,181	\$21,074	\$14,272	\$18,875	\$22,300
(\$/lb)	\$2.70	\$3.07	\$4.37	\$6.28	\$6.68	\$11.02	\$16.87	\$9.56	\$6.47	\$8.56	\$10.12

Sources: INSG; WBMS; LME; Standard CIB Research

Zinc — 2010 a transition year for zinc; bullish for 2011 and beyond

Alongside the other metals, zinc had a strong finish to 2009 and has carried that momentum into this year too.

We have revised our price forecast higher for 2010 and it now stands at \$2,330/tonne from \$2,225/tonne previously, and from an average of \$1,655/tonne achieved in 2009.

Our 2011 price forecast remains unchanged at \$2,550/tonne, but we believe the risks lie increasingly on the upside in the medium to longer term.

For the coming year, zinc prices are likely to continue following copper to a degree, but this market is comparatively well stocked and producers have the tendency to lack discipline. Nevertheless, we do still see zinc getting fundamentally tighter in the coming years, largely on the back of a tightening concentrate market. This is more likely to be felt in 2011 however, with 2010 representing more of a transitional year for zinc.

Also this month we have made some revisions to our supply and demand balance, most notably to our Chinese data where we have seen both supply and demand surprise on the upside.

Production growth starting to become a concern

The zinc industry has a history of lacking discipline and this is becoming evident as smelters, even in the Western World, rushed to restart previously idled capacity in the second half of last year. ILZSG data shows that global production bottomed in January and February at around 830,000 tpm, but by October had recovered steadily to stand at 996,600 tonnes.

Of course, China has been the main driver of this growth, but Western World production has now bottomed and was at its highest level of the year in October (the last month for which data is available) at 520,000 tonnes. Moreover, it will rise further as ramp-ups continue, particularly in Europe, led by Nyrstar.

Chinese production forecasts raised...

In China, production in November was up 9% month-on-month and 41% year-on-year to another record high of 444,546 tonnes.

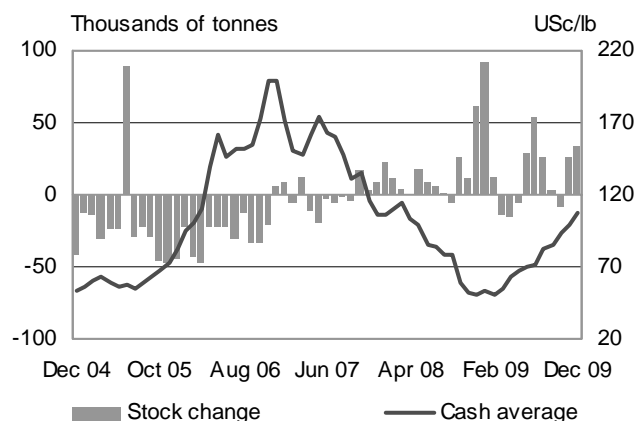
We have raised our estimates for 2009 and our forecasts for 2010 and 2011 in light of how explosive production growth has been and how the regular additions of new capacity will keep growth on an uptrend. Although we note stories early in the New Year about local mines being closed due to extreme weather conditions, our calculations

LME cash and 3-month zinc price



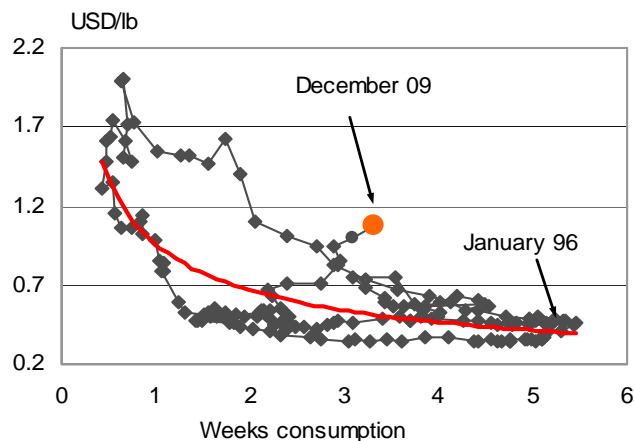
Sources: LME; Standard CIB Research

Monthly change to LME zinc stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME zinc stocks vs. cash price



Sources: LME; Standard CIB Research

show that China still built up a surplus of concentrate in the year to November equivalent to around 700,000 tonnes of contained zinc. Emerging power restrictions might be more of an issue over the coming few weeks, but we have already allowed for a seasonal dip in output over the winter months and we still see annual growth this year of no less than 5-6%.

...demand forecasts also increased

The Chinese galvanized steel market has been boosted over the past year by stimulus spending on infrastructure and incentives aimed at the white goods and automotive sectors. Consumption of galvanized steel in 2009 is likely to have been 20.5-21m tonnes, an increase of 16% year-on-

year, while output is likely to have risen by 11%.

In this context, our previous forecast for zinc consumption growth last year of 6-7% proved to be too cautious and we have revised it up to show double-digit growth both in 2009 and 2010. This year's increase will be underpinned by large additions to domestic HDG production capacity targeting higher grade products for the fast-growing appliance and auto markets.

We maintain a more cautious view on zinc demand outside China this year, but a strong auto market and ongoing stimulus spending in the West should ensure a return to positive growth in 2010. We see growth of 3-4% in Asia and the America's, but a more modest 2% in Europe.

Annual Global Supply/Demand Balance for Zinc, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mine production											
Total	8,933	8,904	9,520	9,709	10,146	10,444	11,129	11,680	11,120	11,350	11,680
Year-on-year % change	1%	(0.3%)	6.9%	2.0%	4.5%	2.9%	6.6%	5.0%	(4.8%)	2.1%	2.9%
Refined production											
Africa	135	147	197	260	273	257	279	262	266	272	276
North America	1,294	1,438	1,431	1,496	1,401	1,377	1,394	1,404	1,240	1,310	1,360
Latin America	423	465	499	496	482	486	545	565	470	510	560
Asia (ex. China)	1,898	2,034	2,136	2,187	2,280	2,412	2,433	2,670	2,620	2,660	2,730
China	2,038	2,155	2,319	2,720	2,776	3,163	3,743	3,913	4,360	4,600	4,700
Australasia	556	567	553	474	457	466	502	499	495	502	510
Europe	2,877	2,904	2,744	2,720	2,563	2,508	2,516	2,470	2,180	2,220	2,300
Total	9,221	9,710	9,879	10,353	10,232	10,669	11,412	11,783	11,631	12,074	12,436
Year-on-year % change	2.7%	5.3%	1.7%	4.8%	(12%)	4.3%	7.0%	3.3%	(1.3%)	3.8%	3.0%
Refined consumption											
North America	1,569	1,634	1,573	1,680	1,496	1,540	1,520	1,478	1,360	1,410	1,480
Latin America	367	389	378	443	414	436	457	471	442	455	474
Asia (ex. China)	2,259	2,359	2,505	2,551	2,525	2,578	2,533	2,510	2,290	2,360	2,510
China	1,500	1,750	2,155	2,690	3,041	3,225	3,597	4,014	4,456	4,901	5,293
Europe	2,817	2,754	2,780	2,833	2,684	2,786	2,850	2,628	2,280	2,320	2,450
Others	405	470	440	457	452	475	480	472	440	470	481
Total	8,917	9,356	9,831	10,654	10,612	11,040	11,437	11,573	11,268	11,916	12,688
Year-on-year % change	(10%)	4.9%	5.1%	8.4%	(0.4%)	4.0%	3.6%	1.2%	(2.6%)	5.8%	6.5%
Implied surplus (deficit)	327	357	55	(269)	(351)	(343)	(15)	210	363	159	(250)
Stocks analysis											
LME	433	651	740	629	394	91	89	254			
SHFE	0	0	0	0	0	0	54	63			
Producer	377	315	293	280	308	332	347	356			
Consumer	120	115	114	116	111	114	101	105			
Merchant	16	14	12	13	15	12	11	12			
Total	946	1,095	1,159	1,038	828	549	602	790	1,153	1,312	1,062
Stocks as weeks of consumption	5.5	6.1	6.1	5.1	4.1	2.6	2.7	3.5	5.3	5.7	4.4
LME cash prices											
Historical & base case (\$/tonn	\$886	\$779	\$828	\$1,048	\$1,382	\$3,273	\$3,250	\$1,873	\$1,612	\$2,330	\$2,550
(cents/lb)	40.2c	35.3c	37.6c	47.5c	62.7c	148.5c	147.4c	85.0c	73.1c	105.7c	115.7c

Sources: ILZSG; WBMS; LME; SHFE; Standard CIB Research

Tin — Onwards and upwards at last

In percentage terms, tin saw the largest rise in LME stocks of all the base metals in 2009. The 245% increase occurred as off-market inventories held at consumers, merchants and producers were flushed out by the large backwardation that was such a dominant feature of the LME tin market for much of last year.

The high stock levels weighed on outright prices and tin ended the year as one of the poorest performers of the complex, despite the re-emergence of significant supply disruptions in Indonesia. Tin, aluminium and nickel prices rose by a comparatively lowly 50-70% over the course of the year, whereas the remaining three base metals more than doubled in value.

However, we are cautiously bullish on tin prices in 2010 and have upgraded our annual forecast this month from \$16,825/tonne to \$17,300/tonne amid what looks set to be a much tighter year fundamentally. We have 2,000-tonne deficit forecast in 2010, but LME stocks are likely to fall much more than this as restocking occurs. This will help to underpin an uptrend in prices. Meanwhile, production disruptions are always likely in tin, and Indonesian supply is set to be capped once again.

Prices finally break to the upside

In recent months we noted that the tin market had been starting to normalize as the anomalously high backwardation finally disappeared and open interest came down. We said last month that tin prices were finally threatening to break higher, having traded in a sideways direction since June when they decoupled from the uptrends in the other metals. Tin did indeed break higher in December, as suspected, ending the year at a 15-month high of \$16,795/tonne. Upwards momentum has continued into January, with three-month prices getting into the mid-\$17,000s.

Tin's late surge meant that it achieved an annual gain of 58% in 2009. Based on our upwardly-revised forecasts, we are looking for a further increase of 29% this year as the global economy recovers, demand improves and as restocking gets under way.

Supply outlook starting to look more robust

The supply side will also have a significant bearing on tin price direction, as major production centres in Indonesia, central Africa and Latin America are prone to disruptions.

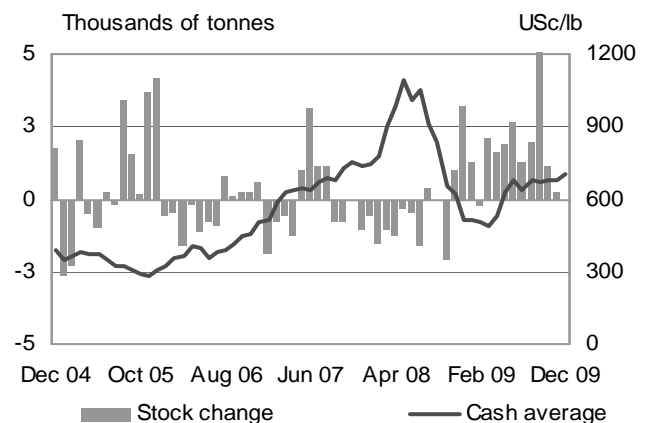
That said, the production outlook is starting to look more robust, if disruptions can be avoided. Developments in the last months alone include the following:

LME cash and 3-month tin price



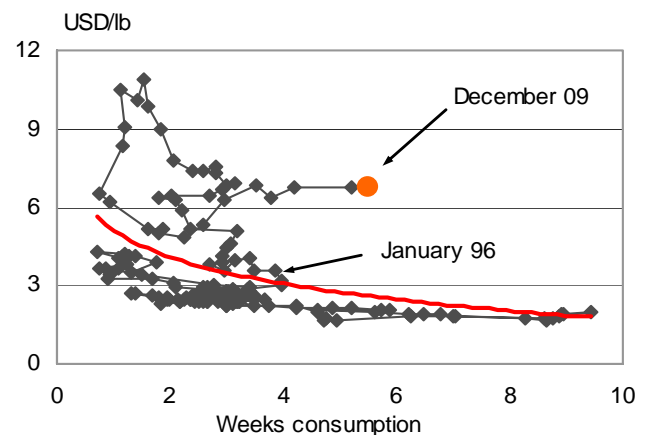
Sources: LME; Standard CIB Research

Monthly change to LME tin stocks vs. cash price



Sources: LME; Standard CIB Research

Month-end LME tin stocks vs. cash price



Sources: LME; Standard CIB Research

- Although workers at the major **Huanuni** tin mine in Bolivia are on strike at the moment, we note that output in November hit 1,000 tonnes, an annualized rate of 12,000 tpy. This far exceeds the 9,320 tonnes achieved in 2009 – itself a record and an increase of 18% - and we should expect further growth in output from this operation in 2010.
 - Two more Ausmelt smelters will be installed in the 2010-2011 period: one at Bolivia's **Vinto** plant which is expanding in tandem with the Huanuni mine, and another at **China Tin**, which will have a capacity of 20,000 tpy.
 - It appears that **Indonesian tin shipments** have started to recover already from the disruption caused by the August-October crackdown on illegal mining.
- Exports in November were 8,166 tonnes, up 16% from October and in line with the monthly average for the year.
- Although ore availability in Indonesia is tight for private smelters at the moment and **PT Koba Tin** missed its 2009 target and has lowered its 2010 target, there is ample spare capacity in the country and we fully expect the national output target of 105,000 tonnes to be achieved.
 - Silver Standard Resources' **Pirquitas** silver-tin-zinc mine in Argentina commenced commercial production of silver at the start of December. Tin production is expected to follow shortly. At full capacity the mine will produce 10m ounces of silver and 2,500 tpy of tin-in-concentrate.

Annual Global Supply/Demand Balance for Tin, 2001-2011

Thousands of tonnes	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mine production											
Total	248	248	255	286	342	335	350	318	305	309	321
Year-on-year % change	13%	0.2%	2.9%	11.9%	19.7%	(2.0%)	4.5%	(9.1%)	(4.1%)	1.3%	3.9%
Refined production											
Latin America	46	54	59	66	63	65	58	61	63	65	69
Asia (ex. China)	103	114	104	112	153	142	131	134	132	133	140
China	106	84	98	117	122	132	149	129	134	132	138
Europe	14	17	14	15	11	11	11	12	9	10	11
Others	2	2	2	3	3	3	2	2	1	1	1
Total	269	269	278	313	352	353	351	338	339	341	359
Year-on-year % change	2.1%	0.1%	3.1%	12.8%	12.6%	0.2%	(0.6%)	(3.7%)	0.3%	0.6%	5.3%
Refined consumption											
North America	53	51	50	59	48	54	40	33	31	32	33
Latin America	12	12	14	16	10	11	9	10	10	11	12
Asia (ex. China)	75	86	90	97	102	109	100	98	85	87	96
China	62	53	72	93	116	115	134	128	136	148	162
Europe	75	69	72	69	65	71	69	66	59	61	65
Others	7	6	5	6	6	5	6	5	4	5	6
Total	283	277	303	341	347	365	358	340	325	344	374
Year-on-year % change	2.3%	(2.1%)	9.3%	12.4%	1.8%	5.2%	(1.9%)	(5.1%)	(4.4%)	5.8%	8.7%
Implied surplus (deficit)	(6)	1	(16)	(19)	13	(3)	(2)	2	14	(2)	(13)
Stocks analysis											
LME	30.6	25.6	14.5	8.1	16.7	13.0	12.1	7.8			
USA	7.7	7.3	6.5	6.1	5.4	5.7	9.1	7.9			
Indonesia	4.3	6.7	6.7	3.8	5.3	5.2	4.6	7.2			
Brazil	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6			
Others	6.1	5.5	6.7	6.4	7.3	6.1	6.0	5.9			
Total	52.3	48.7	38.0	28.0	38.3	33.6	35.4	32.4	46.4	44.4	31.4
Stocks as weeks of consumption	9.6	9.1	6.5	4.3	5.7	4.8	5.1	5.0	7.4	6.7	4.4
LME cash prices											
Historical & base case (\$/tonn	\$4,483	\$4,062	\$4,896	\$8,513	\$7,370	\$8,763	\$14,536	\$18,539	\$13,402	\$17,300	\$20,200
(cents/lb	203.3c	184.2c	222.1c	386.1c	334.3c	397.5c	659.3c	840.9c	607.9c	784.7c	916.3c

Sources: WBS; LME; Standard CIB Research

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