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**KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT**

**FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 1998
WITH
AUDITOR'S REPORT**

**ARTHUR
ANDERSEN
AL-BAZIE & CO.
PUBLIC ACCOUNTANTS**



KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT

FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 1998
WITH
AUDITOR'S REPORT

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ARTHUR
ANDERSEN
AL-BAZIE & CO.

Member of Andersen Worldwide

P.O.Box 2115 Safat
13022 - State of Kuwait
Telephone: (965) 2410010
Facsimile: (965) 2412761

Public Accountants

H.E. The Minister of Oil,
Chairman of the Board of Directors and
Members of the Board of Directors of
Kuwait Petroleum Corporation
State of Kuwait

I have audited the accompanying balance sheet of Kuwait Petroleum Corporation as of June 30, 1998, and the related statements of income and appropriations and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on the audit. I did not audit the financial statements of Kuwait National Petroleum Company K.S.C., Kuwait Oil Tanker Company S.A.K., Petrochemical Industries Company K.S.C., SFIC Holdings (Cayman) Inc. and Kuwait Oil Company K.S.C., which were accounted for in the accompanying financial statements under the equity method of accounting. The investment in these entities represents 24.82 % of total assets and the equity in their net profits represents 18.59 % of net profit for the year. These statements were audited by other auditors whose reports have been furnished to me and my opinion, insofar as it relates to the amounts included for those entities, is based solely on the reports of other auditors.

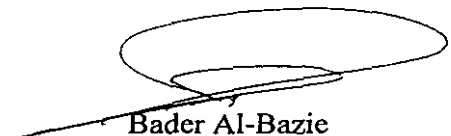
The audit was conducted in accordance with International Standards on Auditing. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that the audit conducted and the reports of other auditors provide a reasonable basis for my opinion.

In my opinion, based on my audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Kuwait Petroleum Corporation as of June 30, 1998, and the results of its operations and its cash flows for the year then ended in conformity with International Accounting Standards.

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Also in my opinion, the statements include the disclosures required by the Law Decree No. 6 of 1980, and I obtained the information I required to perform my audit. In addition, proper books of account have been kept, physical stocktaking was carried out in accordance with recognized practice, and the accounting information given in the Directors' Report is in agreement with the Corporation's books. According to the information available to me, there were no contraventions during the year of the Corporation's Law which might have materially affected the Corporation's financial position or results of its operations.

State of Kuwait
September 17, 1998



Bader Al-Bazie
Licence No. 1-A
Member of Andersen Worldwide

EXHIBIT A

KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT
BALANCE SHEET
June 30, 1998

<u>ASSETS</u>	<u>Note</u>	1998 KD (thousands)	1997 KD (thousands)
Current assets:			
Cash and deposits at banks	3	639,966	1,501,835
Trade receivables		237,898	298,576
Inventories	4	68,133	103,930
Advance to Ministry of Finance		623,062	560,922
Amounts due from subsidiaries		322,562	289,401
Other receivables and prepayments	5	45,444	40,525
Total current assets		<u>1,937,065</u>	<u>2,795,189</u>
Investments:			
Subsidiaries and associates		2,369,733	2,209,099
Neutral zone concession and other investments	6	44,257	44,257
Securities	7	2,207,464	2,027,491
		<u>4,621,454</u>	<u>4,280,847</u>
Loans to subsidiaries	8	657,334	680,551
Finance advances to subsidiary	9	382,986	407,972
Fixed assets:			
Cost		3,555	2,641
Accumulated depreciation		(2,640)	(2,239)
		<u>915</u>	<u>402</u>
		<u>7,599,754</u>	<u>8,164,961</u>
<u>LIABILITIES AND OWNER'S EQUITY</u>			
Current liabilities:			
Trade payables		42	820
Other payables and accruals	10	25,578	23,792
Amounts due to Ministry of Oil	11	166,942	281,398
Amounts due to subsidiaries		89,912	129,214
Profit available for distribution	12	669,320	1,232,523
Total current liabilities		<u>951,794</u>	<u>1,667,747</u>
Other provisions		4,290	3,779
Other non-current liabilities	13	105,820	95,244
Owner's equity:			
Authorized and paid-in capital		2,500,000	2,500,000
Statutory reserve	14	706,415	622,744
Capital reserve	15	232,945	232,945
General reserve	16	1,673,200	1,589,529
Provision for replacement and renewal of fixed assets	17	1,298,691	1,298,691
Foreign currency translation adjustments	18	126,599	154,282
Total owner's equity		<u>6,537,850</u>	<u>6,398,191</u>
		<u>7,599,754</u>	<u>8,164,961</u>

The accompanying notes are an integral part of the financial statements

EXHIBIT B

KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT

STATEMENT OF INCOME AND APPROPRIATIONS
For the year ended June 30, 1998

	Note	1998 KD (thousands)	1997 KD (thousands)
Sales		5,598,690	7,093,027
Cost of sales		(5,345,825)	(6,628,104)
Gross trading profit		<u>252,865</u>	<u>464,923</u>
General and administrative expenses		14,569	13,464
Other costs and expenses	19	<u>5,252</u>	<u>2,123</u>
		<u>19,821</u>	<u>15,587</u>
Operating profit		233,044	449,336
Income from subsidiaries and associates	20	206,010	512,316
Investment income		150,767	118,364
Interest income		119,949	148,826
Other income	21	<u>126,938</u>	<u>140,701</u>
		<u>603,664</u>	<u>920,207</u>
Net profit for the year		<u>836,708</u>	<u>1,369,543</u>
Proposed appropriations:			
Statutory reserve	14	83,671	136,955
General reserve	16	83,671	-
Directors' remuneration		46	65
Profit available for distribution	12	<u>669,320</u>	<u>1,232,523</u>
		<u>836,708</u>	<u>1,369,543</u>

The accompanying notes are an integral part of the financial statements

KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT

STATEMENT OF CASH FLOWS
For the year ended June 30, 1998

	1998 KD (thousands)	1997 KD (thousands)
Cash flows from operating activities		
Net profit for the year	836,708	1,369,543
Adjustments for:		
Depreciation	423	365
Realization of unamortized gain on assets	-	(39,856)
Provisions no longer required	-	(7,762)
Gain on sale of subsidiary	-	(21,925)
Income from subsidiaries and associates	(206,010)	(512,316)
Investment income	(150,767)	(118,364)
Interest income	(119,949)	(148,826)
Provision for employees' termination benefits	511	441
Operating profit before working capital changes	360,916	521,300
Decrease in trade receivables	60,678	16,112
(Increase) decrease in other receivables and prepayments	(3,772)	2
Decrease in inventories	35,797	25
Increase in amounts due from subsidiaries	(33,161)	(35,019)
Decrease in amounts due to subsidiaries	(39,303)	(4,557)
(Decrease) increase in net amounts due to Ministry of Oil	(114,456)	13,155
(Decrease) increase in trade payables	(778)	779
Increase in other payables and accruals	1,806	5,221
Cash generated from operations	267,727	517,018
Paid to directors	(65)	(65)
Net cash from operating activities	267,662	516,953
Cash flows from investing activities		
Increase in neutral zone concession and other investments	-	(3,413)
Interest received	128,241	147,679
Dividends from subsidiaries, associates and other investments	244,950	226,099
Advance to Ministry of Finance	(62,140)	(168,596)
Repayment of subsidiaries' loans	-	172,280
Proceeds from sale of shares in sub-subsidiary	-	384,151
Net increase in investment in subsidiaries	(62,711)	(51,089)
Decrease (increase) in deposits at banks	159,550	(191,515)
Finance advances to subsidiary	24,986	136,681
Net proceeds from sale of subsidiary	-	45,494
Purchase of fixed assets	(936)	(297)
Net increase in investment in securities	(179,973)	(314,375)
Net cash from investing activities	251,967	383,099

(Continued on the following page)

EXHIBIT C
(Continued)

KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT

STATEMENT OF CASH FLOWS
For the year ended June 30, 1998

	1998 KD <u>(thousands)</u>	1997 KD <u>(thousands)</u>
Cash flows from financing activities		
Increase in non-current liabilities	10,576	4,847
Profits distributed	<u>(1,232,523)</u>	<u>(783,622)</u>
Net cash used in financing activities	<u>(1,221,947)</u>	<u>(778,775)</u>
Foreign currency translation adjustments	<u>(1)</u>	<u>3,586</u>
Net (decrease) increase in cash and cash equivalents	(702,319)	124,863
Cash and cash equivalents at beginning of the year	1,102,773	977,910
Cash and cash equivalents at end of the year (Note 3)	<u>400,454</u>	<u>1,102,773</u>

The accompanying notes are an integral part of the financial statements

KUWAIT PETROLEUM CORPORATION
STATE OF KUWAIT

NOTES TO THE FINANCIAL STATEMENTS
June 30, 1998

1. Organization and activities

Kuwait Petroleum Corporation (the Corporation) is wholly owned by the Government of the State of Kuwait. The Corporation was established by the Law Decree No. 6 of 1980 which came into effect on January 27, 1980. The Corporation's principal activities include exploration, drilling, production, storage, refining, processing, transportation, distribution and marketing of crude oil, natural gas, chemical, petrochemical and associated products. All of the Corporation's activities, except for marketing of Kuwait crude oil and petroleum products, are carried out through its subsidiaries and associates. The principal subsidiaries and associates are set out in Note 27.

Crude oil produced in the State of Kuwait becomes the property of the Government of Kuwait, which reimburses the production costs of the producing subsidiary. The Corporation purchases crude oil and natural gas from the Government of Kuwait in accordance with the terms of the Decree issued on January 17, 1981.

With effect from July 1, 1995, the Corporation entered into a commercial processing agreement with one of its subsidiaries, Kuwait National Petroleum Company (KNPC), whereby the Corporation sells crude oil and feedstock to KNPC for refining, and then buys back from KNPC refined products. Prices for these transactions are determined by the agreement.

2. Significant accounting policies

The financial statements are prepared in accordance with Law Decree No. 6 of 1980 and International Accounting Standards. Significant accounting policies are summarized as follows:

a) Accounting convention

The financial statements are prepared under the historical cost convention.

b) Depreciation

The cost of fixed assets is depreciated on a straight-line basis over the expected useful lives of the assets.

c) Investments

Investments are valued as follows:

- Managed portfolios are carried at cost with provision for any permanent decline in value where necessary.
- Treasury bills at cost. Any premium or discount on issue is amortized, on a straight-line basis, from the date of purchase until maturity.
- Subsidiaries and associates in accordance with the equity method of accounting.
- Neutral zone production concession assets at cost.

d) Inventories

Crude oil is valued at the lower of average cost or market value at year-end. The cost of crude oil to the Corporation is determined by the Government of Kuwait in accordance with the Decree issued on January 17, 1981. The formula for establishing the cost of crude oil has been revised in accordance with a resolution by the Supreme Council for Petroleum effective July 1, 1997.

Liquefied petroleum gas and finished products are valued at the lower of cost or net realizable value. Cost is determined using the weighted average method on an individual product basis.

e) Employees' termination benefits

Provision is made for amounts payable to employees under the Kuwait Labor Law, Kuwait Social Security Law and the Corporation's terms of employment.

f) Petroleum personnel provident fund scheme

The Corporation and its Kuwait subsidiaries contribute to the petroleum personnel provident fund scheme in accordance with the terms of the provident fund plan for Kuwaiti personnel employed in the oil sector, which represents a defined benefit plan.

g) Foreign currencies

Foreign currency transactions are recorded in Kuwaiti Dinars at the previous month's average rates of exchange. Monetary assets and liabilities denominated in foreign currency at the balance sheet date are translated to Kuwaiti Dinars at the rates of exchange prevailing on that date. Exchange differences arising from the translation of the financial statements of subsidiaries and associates together with loans that, in substance, form part of the Corporation's net investment in such entities are accumulated in a separate component of owner's equity (foreign currency translation adjustments) until the disposal of the subsidiary or associate. Other exchange differences are reported as part of the results for the year.

h) Sales

Sales are recognized at the date title passes to the customer in accordance with the contract of sale.

i) Cash equivalents

Cash equivalents for the purpose of preparing the statement of cash flows comprise bank deposits with a maturity date not exceeding 3 months from the date of deposit.

3. Cash and deposits at banks

	1998 KD (thousands)	1997 KD (thousands)
Cash and current accounts at banks	153	106
Short-term deposits maturing within 3 months	400,301	1,102,667
Cash and cash equivalents	400,454	1,102,773
Short-term deposits maturing after more than 3 months	239,512	399,062
	<u>639,966</u>	<u>1,501,835</u>

4. Inventories

	1998 KD (thousands)	1997 KD (thousands)
Finished petroleum products	1,085	8,354
Crude oil	67,048	95,576
	<u>68,133</u>	<u>103,930</u>

5. Other receivables and prepayments

	1998 KD (thousands)	1997 KD (thousands)
Sundry receivables	10,177	7,880
Accrued income	31,652	28,910
Prepaid expenses	923	1,254
Deferred expenses	2,692	2,481
	<u>45,444</u>	<u>40,525</u>

6. Neutral zone concession and other investments

	1998 KD (thousands)	1997 KD (thousands)
Neutral zone concession	38,528	38,528
Other investments	5,729	5,729
	<u>44,257</u>	<u>44,257</u>

7. Securities

	1998 KD (thousands)	1997 KD (thousands)
Managed portfolios	2,207,464	1,926,825
Treasury bills and bonds	-	100,666
	<u>2,207,464</u>	<u>2,027,491</u>

8. Loans to subsidiaries

Loans to subsidiaries represent foreign currency loans to subsidiaries of Petrochemical Industries Holdings N.V.

Most of the loans maturing in June 30, 1998, were renewed in accordance with new agreements entered into with the subsidiaries effective July 1, 1998. The repayment terms of the new agreements generally extend beyond June 30, 2002 with interest rates varying from 4.7% to 5.75% per annum.

9. Finance advances to subsidiary

	1998 KD (thousands)	1997 KD (thousands)
Balance at beginning of the year	407,972	544,653
Advances to finance capital projects	56,439	61,407
Repayment of capital advances	(81,425)	(84,850)
Amounts (repaid) advanced to purchase opening oil inventories based on new agreement	-	(113,238)
Balance at end of the year	<u>382,986</u>	<u>407,972</u>

Finance advances consist of advances for capital projects and purchase of inventories by KNPC. No interest is charged on amounts advanced to finance major capital projects. As agreed with KNPC, amounts advanced to finance capital projects are repaid in line with the related depreciation charge for the major capital projects.

10. Other payables and accruals

	1998 KD (thousands)	1997 KD (thousands)
Payroll and annual leave	1,389	1,301
Marine payables	19,125	17,920
Other payables	5,064	4,571
	<u>25,578</u>	<u>23,792</u>

11. Amounts due to Ministry of Oil

Amounts due to the Ministry of Oil represent the net amounts payable for purchases of crude oil and natural gas, and certain activities performed by the Corporation and its subsidiaries on behalf of the Ministry of Oil (as described in Note 22). Production costs, including extraordinary items of Kuwait Oil Company K.S.C., are charged to this account.

12. Profit available for distribution

	1998 KD (thousands)	1997 KD (thousands)
Balance at beginning of the year	1,232,523	783,622
Profit distributed during the year	(1,232,523)	(783,622)
Profit for the year available for distribution	669,320	1,232,523
Balance at end of the year	669,320	1,232,523

13. Other non-current liabilities

Other non-current liabilities represent amounts transferred from local subsidiaries equivalent to the subsidiaries' statutory reserve in accordance with their Articles of Association. The amounts are interest free and do not have a fixed repayment date.

14. Statutory reserve

	1998 KD (thousands)	1997 KD (thousands)
Balance at beginning of the year	622,744	485,789
Transfer for the year	83,671	136,955
Balance at end of the year	706,415	622,744

As required by Article 12 of the Law Decree No. 6 of 1980, 10% of net annual profit is transferred to statutory reserve. Such transfers discontinue when the reserve equals half the capital.

15. Capital reserve

The capital reserve mainly represents the difference between the Corporation's cost of acquisition of its original subsidiaries, which were transferred by the Government of Kuwait, and their net asset values at December 31, 1979.

16. General reserve

	1998 KD (thousands)	1997 KD (thousands)
Balance at beginning of the year	1,589,529	1,589,529
Transfer for the year	83,671	-
Balance at end of the year	<u>1,673,200</u>	<u>1,589,529</u>

In accordance with Article 12 of the Law Decree No. 6 of 1980, the Board of Directors proposes to transfer 10% of net profit for the year ended June 30, 1998 to the general reserve. This proposal is subject to the approval of the Supreme Council for Petroleum.

17. Provision for replacement and renewal of fixed assets

Article 10 of the Law Decree No. 6 of 1980 states that the Corporation may provide an amount of its profits to meet the costs of replacement and renewal of the Corporation's and its subsidiaries' fixed assets, after approval of the Supreme Council for Petroleum. The provision is based on the difference between depreciation, calculated on the historical cost of fixed assets of the Corporation and its Kuwaiti subsidiaries, and depreciation calculated on the replacement cost of the assets using their insured values. No appropriations were made for the years ended June 30, 1994 through 1998.

18. Foreign currency translation adjustments

	1998 KD (thousands)	1997 KD (thousands)
Balance at beginning of the year	154,282	249,969
Net exchange differences for the year	(27,683)	(95,687)
Balance at end of the year	<u>126,599</u>	<u>154,282</u>

19. Other costs and expenses

	1998 KD (thousands)	1997 KD (thousands)
Provision for doubtful debts	935	2,066
Financial charges	16	45
Prior year expense	4,301	-
Other expenses	-	12
	<u>5,252</u>	<u>2,123</u>

The prior year expense represents the refund of amounts previously charged to KNPC in excess of the Kuwait Export Crude Price Index.

20. Income from subsidiaries and associates

This amount represents the Corporation's share in the net results of subsidiaries and associates as follows:

	1998 KD (thousands)	1997 KD (thousands)
Kuwait National Petroleum Company K.S.C.	52,402	132,428
Kuwait Oil Tanker Company S.A.K.	24,039	18,352
Petrochemical Industries Company K.S.C.	21,339	30,737
Kuwait Foreign Petroleum Exploration Company K.S.C.	17,892	14,399
Kuwait Aviation Fuelling Company K.S.C.	6,715	5,597
Kuwait Santa Fe for Engineering and Petroleum Projects Company - K.S.C.	496	362
SFIC Holdings (Cayman) Inc.	57,837	293,130
Petrochemical Industries Holdings N.V.	(1,482)	(3,095)
KPC Holdings (Aruba) AEC	19,226	10,837
Kuwait Petroleum Corporation (Liberia)	-	(2)
Kuwait Petroleum Corporation (Western Hemisphere)	30	19
Kuwait Petroleum Corporation (Far East)	(19)	31
Gulf Industrial Investment Company E.C.	6,037	7,675
Compagnie d'Investment dans les technologies Avancees	1,253	1,585
Kuwait Drilling Company K.S.C.	245	261
	<u>206,010</u>	<u>512,316</u>

Included in the Corporation's share in the net results of SFIC Holdings (Cayman) Inc. in 1997, is the gain of US \$ 788 million (KD 237 million) realized on the issuance in an initial public offering of 40 million shares of SFIC Holdings' subsidiary, Santa Fe.

21. Other income

	1998 KD (thousands)	1997 KD (thousands)
Recovery of financing costs	64,086	56,731
Gain on sale of subsidiary	-	21,925
Provisions no longer required	-	7,762
Foreign currency exchange gain	61,354	13,617
Miscellaneous income	1,498	40,666
	<u>126,938</u>	<u>140,701</u>

The gain on sale of subsidiary relates to the sale of KP North Sea Holdings (KPNSH) in July 1996.

21. On formation of KPNSH, certain fixed assets relating to SFIC Holdings (Cayman) Inc. were sold to KPNSH at a price that exceeded the net book value of the assets. That excess was being amortized to income over the remaining useful lives of the assets. Miscellaneous income for 1997 includes the unamortized balance of KD 39.8 million which was realized on the sale of KPNSH.

22. Activities on behalf of the Ministry of Oil

The Corporation and its subsidiaries perform certain activities on behalf of the Ministry of Oil primarily in relation to: (a) the exploration for and production of crude oil and natural gas in the State of Kuwait, and (b) the local marketing (within the State of Kuwait) of refined products and liquefied petroleum gas.

23. Financial instruments

In the normal course of business, the Corporation uses primary financial instruments such as cash and deposits, investments, receivables and payables. The Corporation does not make use of derivative financial instruments.

- Fair values

Except for managed portfolios whose fair value amounted to KD 2,310 million at June 30, 1998 (1997 - KD 1,947 million), the carrying amounts of financial instruments approximate their fair values due to the short maturities and the nature of such instruments.

- Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation causing the other party to incur a financial loss. The financial instruments which potentially subject the Corporation to credit risk consist of cash and deposits at banks, investments and receivables. The Corporation's bank balances and investments are placed with highly reputed financial institutions. The Corporation deals mainly with major international, state owned and large independent oil companies, and all receivables are presented net of allowance for doubtful debts.

- Interest rate risk

Deposits at banks are mainly denominated in U.S. Dollars and Kuwaiti Dinars. The deposits earn interest between 5.5% to 7% p.a. and mature within 3 months to 1 year from the balance sheet date.

24. Segment information

The Corporation operates substantially in only one geographical segment, the State of Kuwait, and in one business segment, the marketing and distribution of petroleum products.

25. Contingent asset

The Corporation is pursuing claims against Iraq for the recovery of losses suffered by the Corporation during the Iraqi invasion. The accompanying financial statements do not include amounts related to these potential claims.

26. Comparative figures

Certain of the prior year amounts have been reclassified to conform with the current year presentation.

27. Subsidiaries and associates

a) Principal directly and wholly-owned subsidiaries incorporated in the State of Kuwait

	Authorized capital KD (thousands)	Paid-up capital KD (thousands)	Shareholder's equity KD (thousands)	Principal activities
Kuwait Oil Company K.S.C.	30,188	30,188	714,172	Exploration for and production of crude oil and natural gas in the State of Kuwait including processing and export.
Kuwait National Petroleum Company K.S.C.	260,000	260,000	386,911	Refining, LPG manufacturing, export and local marketing of refined products.
Kuwait Oil Tanker Company S.A.K.	200,000	200,000	217,969	Operation of a fleet of crude oil tankers and liquefied petroleum gas and oil product carriers.
Petrochemical Industries Company K.S.C.	315,000	315,000	325,625	Production of petrochemical products and their distribution and marketing.
Kuwait Foreign Petroleum Exploration Company K.S.C.	200,000	200,000	154,474	Exploration and development of oil and gas outside the State of Kuwait.

	Authorized capital KD (thousands)	Paid-up capital KD (thousands)	Shareholder's equity KD (thousands)	<u>Principal activities</u>
Kuwait Santa Fe for Engineering and Petroleum Projects Company K.S.C.	1,000	1,000	3,014	Provision of design, engineering and related services to the petroleum industry.
Kuwait Aviation Fuelling Company K.S.C.	30	30	4,852	Supply of aviation fuel.

b) Principal directly and wholly-owned subsidiaries incorporated outside the State of Kuwait

	Country of incorporation	Paid-up capital KD (thousands)	Shareholder's equity KD (thousands)	<u>Principal activities</u>
SFIC Holdings (Cayman) Inc.	Cayman Islands	14	236,887	International contract drilling.
KPC Holdings (Aruba) AEC	Aruba	602,238	404,793	Refining and marketing of refined products.

	Country of incorporation	Paid-up capital KD (thousands)	Shareholder's equity KD (thousands)	Principal activities
Petrochemical Industries Holdings N.V.	Netherlands Antilles	9,697	(203,332)	Investment in other companies and financing activities.
Gulf Industrial Investment Company (E.C.)	Bahrain	30,521	36,890	Production of iron ore pellets.

c) Principal associates

<u>Name of Company</u>	<u>Country of incorporation</u>	<u>Proportion held</u>	<u>Nature of business</u>
Kuwait Drilling Company K.S.C.	Kuwait	49%	Contract drilling.