

# REVIEW OF OPERATIONS

**Don MacLeod**  
*Managing Director*



## FINANCIAL RESULTS

The group achieved excellent results for the year ended 31 March 2006. This was due to increased sugar production in South Africa and record sugar output in all the group's other countries of operation, along with a general improvement in domestic sales, a significant increase in world and regional sugar prices, cost savings and a material reduction in financing costs. The change in the value of growing cane, largely as a result of increased sugar prices, enhanced earnings from cane growing. Combined, these factors more than offset the negative impact of the continuing strong rand in respect of both sugar and downstream exports and the translation of foreign profits. Headline earnings increased significantly to R352.4 million, an increase of 129% over the previous year's re-stated earnings of R153.8 million. Headline earnings per share also increased substantially by 127% to 104.2 cents.

Impacted by the sale of certain businesses in 2004/05, group revenue increased by R366.1 million to R5 468.8 million, whilst operating profit rose from R423.7 million to R751.5 million, resulting in an improved operating margin of 13.7%. Net financing costs continued their downward trend

from R153.9 million to R100.9 million, whilst taxation increased from R88.9 million to R197.3 million, primarily due to the improved earnings. The effective tax rate, excluding material items, was 30.3%. Profit after tax more than doubled to R456.8 million.

Cash generation of R310.8 was strong, whilst group borrowings decreased significantly from R801.6 million to R441.0 million and gearing from 54.7% to 24.3%.

The contributions to operating profit were: sugar production 61%, cane growing 31% and downstream 8%. By country, contributions were: South Africa 21%, Malawi 39%, Zambia 20%, Swaziland 10%, Tanzania 9% and Mozambique 1%.

The group has adopted International Financial Reporting Standards for the first time and has changed its accounting policies to comply with IFRS 2 (share-based payments), IAS 16 (property, plant and equipment), IAS 17 (operating leases) and IAS 31 (interest in joint ventures) with retrospective effect from 1 April 2004.

# REVIEW OF OPERATIONS CONTINUED

## OVERVIEW

Overall, the group's operational performance exceeded that of previous years, with record sugar production in Malawi, Zambia, Swaziland, Tanzania and Mozambique and increased sugar production in South Africa. The downstream plants enjoyed another year of good performance, with new records in ethyl alcohol and diacetyl output being achieved. Revenue benefited from very good domestic market sales in Malawi, improved offtake in South Africa and Tanzania, and from higher world and regional sugar prices. Sugar shipments to preferential markets in Europe were completed in full, with three of the group's countries of operation deriving additional advantage from a reallocation of export quota under the Everything But Arms (EBA) agreement for the year to June 2006.

Whilst the countries in which the group has operations experienced varying climatic conditions leading up to and during the 2005/06 season, an underlying feature of the increase in the group's cane production to 5.46 million tons was the good overall performance of its agricultural operations. The importance of secure irrigation sources and infrastructure was particularly evident in Zambia and Swaziland, where very dry conditions were offset by effective irrigation. As a result of good cane yields, record cane production was achieved in Malawi, Zambia and Mozambique, and efficient harvesting and haulage operations ensured that the factories were well supplied with high quality cane.

Group sugar production amounted to 1.87 million tons, with record output in all countries of operation outside South Africa. Excluding production from the Umfolozi mill

which was sold prior to the start of the 2005/06 season, South African production increased by 20%. The operational performance of the factories was very satisfactory. Major refinery expansions have been undertaken at the Pongola and Noodsberg factories, which will extend refined sugar capacity in South Africa beyond that which existed prior to the sale of the Umfolozi mill.

Domestic market sales across the group were encouraging, particularly in Malawi where selling volumes were 20% above those of the previous year, and in South Africa and Tanzania which achieved increased offtake. Sales in Swaziland and Mozambique were in line with previous levels. The group continued to focus on marketing initiatives and improved distribution, particularly in the rural areas. Illegal imports impacted negatively on local sales in Zambia. However, generally the authorities responded positively to counter illegal imports, where they occurred.

The performance of the downstream operations across the group was good, with record production of diacetyl at the Sezela complex and ethyl alcohol at the Merebank operation. Speciality sugars for the European Union (EU) market were produced for the first time at Zambia Sugar. Sales of furfural, furfuryl alcohol, diacetyl and lactulose exceeded those of last year, whilst the offtake of ethyl alcohol remained strong at the previous year's levels.

World sugar prices continued to be volatile, but maintained their upward trend during the season, fuelled primarily by the ongoing global production deficit which is currently in its third year. In addition to various weather-related factors in



*An underlying feature of the increase in the group's cane production to 5.46 million tons was the good overall performance of its agricultural operations. As a result of good cane yields, record cane production was achieved in Malawi, Zambia and Mozambique.*



*Major refinery expansions have been undertaken at the Pongola and Noodsberg factories, which will extend refined sugar capacity in South Africa beyond that which existed prior to the sale of the Umfolozi mill.*

some major producing areas such as the United States, Thailand, China and Brazil, significant longer-term structural changes have also occurred within the world sugar market during the past 12 months. This includes the approval of the EU sugar regime reform package, which is expected to reduce annual sugar production by between five and seven million tons, thereby changing that region from a significant exporter of sugar to a net importer. Further, there is growing interest world-wide in ethanol from sugar cane as a bio-renewable energy source. World raw sugar prices commenced the 2005/06 season at around US8.0 cents/lb, peaked at around US19.7 cents/lb in February 2006 and ended the financial year in the US17.0 to US18.0 cents/lb range. These factors have created a positive background for continuing stronger prices compared to the more recent past. As a result of the stronger world price, prices for sugar sold into Illovo's

regional markets firmed, whilst refined sugar premiums also improved.

Total capital expenditure in 2005/06 amounted to R205.0 million, of which expansion capital for projects aggregated R84.2 million and included the expansion of both the Pongola and Noodsberg refineries. Ongoing capital expenditure ensures that the group's factories are kept in sound condition, that strategic plant is adequately protected against breakdown, and that product quality meets world standards.

Illovo has recently qualified for inclusion in the JSE's Socially Responsible Investment (SRI) Index. The company also won the Industrial and Manufacturing category of the South African Annual Report Awards.

# REVIEW OF OPERATIONS CONTINUED



*A significant strength of the group was that 69% of sugar production by volume and 80% by value was sold into the domestic or premium-priced export markets. During 2005/06, the group exported sugar to 63 countries.*

## MARKETS

The group supplies sugar and downstream products to domestic, regional and export markets. Sales to the domestic markets in the countries in which the group operates contributed 63% to total revenue, whilst exports to 102 countries contributed the balance. A significant strength of the group was that 69% of sugar production by volume and 80% by value was sold into the domestic or premium-priced export markets.

### Domestic markets

#### Sugar

The South African Customs Union (SACU) market is of major significance for both the South African and Swaziland sugar industries. During the season, total sales into SACU amounted to 1.704 million tons, about 80% being refined sugar and the balance brown sugar. The South African sugar industry supplied 1.268 million tons, Swaziland 316 000 tons and Zimbabwe and other Southern African Development Community (SADC) sugar producing countries 120 000 tons.

In South Africa, approximately 50% of total production is sold into the domestic SACU market. Illovo Sugar is Malawi's sole sugar producer and in the 2005/06 season, domestic sales comprised approximately 65% of total sales. Approximately 94% of Zambia's sugar output is produced by Zambia Sugar and 39% of total sales was sold locally. In Swaziland, Ubombo is one of three producers and its production constitutes about 36% of the country's total output. Swaziland's domestic sales in 2005/06 represented half of total sales. Tanzania is a net importer of sugar with annual domestic demand being about 296 000 tons. Aside from relatively small export tonnages sold into preferential markets in the EU, about 90% of Kilombero's total sales went into the domestic market. Sugar production in Mozambique, which has four sugar producers, currently amounts to about 265 000 tons. Approximately 54% of Maragra's total sugar sales in 2005/06 was sold domestically.

### Downstream

Whilst the group's range of downstream products is primarily aimed at export markets, the Merebank and Glendale distilleries remain important suppliers of ethyl alcohol to the South African liquor, pharmaceutical and industrial chemical industries. Relatively small volumes of furfural and its derivatives, as well as lactulose, are traditionally sold in the local South African market, whilst Crop Guard is presently produced exclusively for the domestic market. In South Africa and Zambia, a range of syrups and speciality sugars are produced mainly for the domestic markets.

### Export Markets

#### Sugar

##### Preferential markets

The group has significant access to preferential markets in the EU and the United States (US) which are supplied by producers with export quotas to these regions at a marked premium to the world free market price. During the year, the group's preferential exports from its countries of production outside South Africa amounted to approximately 180 000 tons. Combined, Malawi, Zambia and Mozambique supply around 25 000 tons of sugar into the SACU market in terms of the SADC Sugar Protocol.



*Domestic market sales across the group were encouraging, particularly in Malawi where selling volumes were 20% above those of the previous year, and in South Africa and Tanzania which achieved increased offtake.*

#### World markets

More than 100 countries produce sugar, 74% of which is made from sugar cane grown primarily in the tropical and sub-tropical zones of the southern hemisphere, and the balance from sugar beet which is grown mainly in the temperate zones of the northern hemisphere. Generally, the costs of producing sugar from sugar cane are lower than those in respect of processing sugar beets. Currently, 69% of the world's sugar is consumed in the countries of origin, whilst the balance is traded on world markets. Because of the residual nature of the world market, the free market price is one of the most volatile of all commodity prices.

The five largest exporters in 2005/06, Brazil, the EU, Australia, Thailand and the SADC, are expected to supply approximately 76% of all world free market exports. South Africa is the ninth largest exporter.

Following on from the increase in the world raw sugar price in the previous season, due primarily to an approximate 2.5 million ton global production deficit, futures prices continued to trade at around US9.0 cents/lb until the end of August 2005. The hurricanes which struck Florida and Louisiana in the US in September 2005 and the realisation that the Brazilian cane crop was going to be smaller than originally anticipated, provided the impetus for the world price to firm to the US10.0/11.0 cents/lb range in October 2005. It remained at these levels until the end of 2005. However, early in the new year, a significant increase in physical demand by a number of countries, including India, Sudan, Iran, China and Pakistan, together with the newly-approved EU sugar regime reform package, and the growing interest world-wide in ethanol from sugar cane as a

bio-renewable energy source, resulted in a surge in the world sugar price during the first three months of 2006. This, together with speculative buying, resulted in futures prices rising to a 25-year high with a price of US19.7 cents/lb being achieved on 3 February 2006. During May 2006, the price was trading at around US17.0 cents/lb.

As a major exporter to the world market in 2005/06, the South African Sugar Association (SASA) exported 940 000 tons of raw sugar on behalf of the producers. Exports achieved an average price of US9.79 cents/lb and realised around R1.937 billion. Refined and direct consumption raw sugar exports, amounting to 300 000 tons, were undertaken by the producers themselves.

Bulk sugar exports to the world market from Illovo's South African operations represented 46% of production, whilst world exports were also undertaken by Swaziland and Mozambique. South Africa, Malawi, Mozambique, Swaziland and Zambia exported sugar to a number of regional markets, where selling prices are based on the world market price. In all instances, however, premiums above the world price are achieved as a result of various competitive advantages. With the improved world price, these regional markets have become more attractive.

#### Downstream

The group is a material player in most of the world markets in which it participates, and exports furfural, furfuryl alcohol, diacetyl, 2,3-pentanedione, ethyl alcohol, lactulose and certain speciality sugars to 94 countries. In the financial year under review, downstream product sales contributed R504.1 million to group revenue.

# REVIEW OF OPERATIONS CONTINUED



*Sugar production in South Africa, excluding output from the Umfolozi mill which was sold in March 2005, increased by 20% over that of last year to 906 000 tons following a successful milling season. Overall, mechanical and operational performance was good.*

## OPERATIONS

### SOUTH AFRICA

Illovo is South Africa's largest sugar producer, with its operations strategically located across the eastern section of KwaZulu-Natal, maximising the benefit of a wide geographic spread, which incorporates the coastal, midlands and northern irrigated cane growing regions. The operations consist of three agricultural estates, five sugar factories, two of which incorporate refineries, and five downstream plants. Currently, average annual cane and sugar production amount to approximately 500 000 tons and 900 000 tons respectively. Furfural, furfuryl alcohol, Crop Guard, diacetyl, 2,3-pentanedione, ethyl alcohol, lactulose and syrup are also produced at various downstream plants.

#### *Agriculture*

Improved agricultural conditions resulted in better yields than last season and the production of 485 000 tons of cane. This was slightly below that of last year, as a result of the sale of a large-scale farm to a Black economic empowerment (BEE) grower at Sezela. Widespread rains in the first quarter of 2006 have promoted good cane growth across all of Illovo's cane growing regions, which augurs well for a further improvement in cane production in 2006/07.

Cane delivered to the mills by Black medium-scale growers amounted to 280 000 tons. The company continues to provide agricultural and other support to these growers. Accumulative sales of cane land to Black farmers and to BEE companies now represents 54.3% of the company's previously owned cane lands.

Production by small-scale farmers who delivered their production to Illovo mills declined to about 480 000 tons of cane, representing a decrease of approximately 17% from the previous year. This was largely as a result of the sale of the Umfolozi mill which had a significant small-scale farmer cane supply, and the very dry conditions prevailing in the previous season which negatively impacted on these growers' cash flow. This in turn resulted in reduced ratoon management of their crops. Illovo has recently embarked on a programme of assisting these growers with ratoon management and re-planting programmes. The company has secured R4.1 million in grant funds to assist the small-scale growers who deliver their cane to the Sezela and Umzimkulu mills, which should help to re-establish production in these areas.



*Improved agricultural conditions in South Africa resulted in better yields than last season and the production of 485 000 tons of cane.*

### **Sugar production**

Sugar production, excluding output from the Umfolozi mill which was sold in March 2005, increased by 20% over that of last year to 906 000 tons following a successful milling season. Overall, mechanical and operational performance was good, with Umzimkulu and Sezela setting new seasonal records for sugar extraction and value recovered. Eston also performed well, establishing several new performance records. Pongola and Noodsberg experienced disappointing seasons, with difficult processing conditions and poor mechanical efficiencies impacting on the recovery of sugar from cane. Major refinery expansions have been undertaken at both these factories in the past year, including a new sugar conditioning tower at Pongola and the relocation of the packing station from Umfolozi to Noodsberg and its consolidation with the existing plant. Once in full operation, the company's refined sugar capacity in South Africa will exceed that available prior to the sale of the Umfolozi mill.

With the anticipated increase in cane supplies due to improved growing conditions, sugar production in 2006/07 is expected to exceed that of last season.

### **Downstream**

The furfural downstream plant at Sezela operated well, with furfural production exceeding that of last year by 12% due to higher cane throughput at the sugar factory. Having resolved the quality problems experienced last season, diacetyl production also benefited from the plant expansion and a material increase in output was achieved. During the year, the first phase of a furfural effluent treatment plant, based on new technology was commissioned. This plant will also provide the Sezela complex with a significant quantity of recycled water. The Merebank alcohol plant operated very well, with weekly production rates consistently exceeding previous levels, and achieved record annual production. The Merebank lactulose plant also performed well, whilst the operation of the syrup plant and the Glendale distillery was satisfactory.

### **Marketing**

Illovo sells raw, brown and refined sugar, speciality sugars, syrup, furfural and its derivatives, potable and denatured alcohols and lactulose into local and international markets. During 2005/06, domestic sugar sales increased by about 4% over that of the previous year. The revenue earned from the domestic market amounted to 71% of total revenue from sugar sales. Illovo remains the major supplier of sugar to the South African industrial market.



*Diacetyl production benefited from a recent plant expansion and a material increase in output was achieved.*

# REVIEW OF OPERATIONS CONTINUED

*In 2005/06 domestic sugar sales in South Africa increased by 4% over the previous season. A new sugar pack design has recently been introduced as part of the "Illovo iGrand" marketing campaign.*



Exports of refined sugar and direct consumption raws are undertaken by Southern Cross Sugar Exports (Pty) Limited on behalf of South African producers. During the 2005/06 season, approximately 31 000 tons of these sugars were exported on behalf of Illovo to a number of African and other countries, and benefited from good white sugar premiums.

Illovo's raw sugar exports to the world market, undertaken by SASA, amounted to 417 000 tons. The average price realised by the industry, including hedging activities undertaken by SASA, was US9.79 cents/lb. In respect of the 2006/07 season, around 500 000 tons of world market sugar have been priced by SASA at an average price of US15.16 cents/lb.

During the past season, Illovo produced approximately 315 000 tons of molasses. Domestic sales improved by about 7% to 290 000 tons, reflecting primarily the ongoing growth in the local fermentation industry. The balance was exported, with the group benefiting from improved international molasses prices due to increased global demand for alcohol.

Strong demand for furfural and furfuryl alcohol in Europe resulted in good prices being achieved for both products at the start of the season. Chinese producers then increased exports and as a result of the increased supply, furfuryl alcohol prices in Europe fell during the second half of the season. However, increased costs of production in China slowed this price erosion compared to previous cycles. Strong demand for the products was also experienced in the US with prices

remaining stable. Following the recent plant expansion, diacetyl sales reached record levels, although prices were lower than those achieved in the previous year.

Despite enhanced marketing initiatives, efforts to improve Crop Guard sales were hampered by the delay in obtaining registrations for its use as a nematicide on additional crops. Registration of the product in the US continues to be pursued through the Environmental Protection Agency.

Merebank experienced a year of good domestic and export market sales, despite the national transport strike and the ensuing backlog caused at the Durban port which delayed export shipments. Lactulose sales remained strong, with good growth in the domestic market.



*The 2005/06 season in Malawi was the company's best to date, with record cane and sugar production and strong domestic sales. The agricultural estates at Nchalo and Dwangwa enjoyed excellent seasons, achieving record production of 1.95 million tons of cane.*



*A record 270 000 tons of sugar was produced with both Nchalo and Dwangwa performing well.*

## MALAWI

Illovo Sugar (Malawi) Limited is Malawi's sole sugar producer with two operations, Dwangwa situated geographically in the centre of the country and Nchalo in the south. Combined, the two estates annually produce almost two million tons of cane from fully irrigated fields and approximately 270 000 tons of sugar. Speciality sugars are produced at Nchalo. The 2005/06 season was the company's best to date, with record cane and sugar production and strong domestic sales. Illovo Sugar (Malawi) is listed on the Malawi Stock Exchange. The Illovo group has a 76% shareholding, with the balance of shares held by institutional and private investors.

### Agriculture

Both agricultural estates enjoyed excellent seasons, achieving record production of 1.95 million tons of cane. At Nchalo, where power outages impacted negatively on irrigation operations last season, power supplies were restored, allowing full irrigation of the crop. This, together with improved management practices, resulted in cane yields well in excess of those previously achieved. Dry weather conditions experienced at both operations during the milling season enhanced harvesting and haulage activities. Local Malawian growers delivered 190 000 tons of cane to the factories.

Good and well distributed summer rains, interspersed with hot, sunny days, have resulted in excellent growing conditions on both estates ahead of the 2006/07 season.

### Sugar production

Efficient factory operations at Nchalo resulted in consistent cane crush rates being maintained, with a new record weekly cane-throughput being achieved. At Dwangwa, after a difficult start-up, milling performance improved significantly and several new factory performance records were established. Both refineries ran well, often at capacity for extended periods. A record 270 000 tons of sugar was produced by the two operations. It is anticipated that increased cane supplies and improved factory performances will result in a further increase in sugar production in the 2006/07 season.

### Downstream

Nchalo produces various speciality sugars which are sold to EU markets at price premiums. Increasing quantities were also sold into the US. Illovo Sugar (Malawi) is a minority shareholder in the Ethco Distillery at Dwangwa, which utilises molasses from the company.

### Marketing

Local market sales volumes increased by 20% over last year as the result of ongoing efforts to improve distribution in the rural areas, including the successful implementation of a depot and agency incentive programme. Domestic market offtake represented 65% of total sales, which was a significant increase over previous levels. Improving port operations at Nacala and Beira in Mozambique facilitated the supply of sugar to Malawi's preferential EU and US markets. As a result of other Least Developed Countries (LDC's) being unable to meet their country entitlements, Malawi benefited from an additional EBA quota allocation for the period to June 2006. Regional sales had to be cut back to accommodate the increased domestic sales and preferential exports, but prices were much firmer, consistent with the improved world price.



*Ongoing efforts to improve distribution in the rural areas, including the successful implementation of a depot and agency incentive programme, resulted in record domestic sales, representing 65% of total sales.*

# REVIEW OF OPERATIONS CONTINUED



*Several new factory performance records were established by Zambia Sugar, and record production of 247 000 tons of sugar was achieved.*

*Good management of the water supply available to the operations offset the negative impact of the drought conditions experienced in Zambia.*



## ZAMBIA

Zambia Sugar Plc, which is listed on the Lusaka Stock Exchange, is the country's principal sugar producer, with a 94% share of industry production. The Illovo group holds 90% of the issued share capital, with the remaining shares held by private and institutional investors. The operation is based at Nakambala, adjacent to Mazabuka in the south of the country, and annually produces around 1.3 million tons of cane and 250 000 tons of sugar. Syrup and speciality sugars are also produced.

### *Agriculture*

Drought conditions, experienced across Zambia, significantly increased the demand for water on the company's agricultural estates. Good management of the water supply available to the operations, however, offset the impact of the dry weather and, combined with favourable conditions for cane harvesting and haulage, resulted in a record cane crop of 1.29 million tons. Following good summer rainfall and excellent growing conditions, cane yields in 2006/07 are expected to be at least as good as last year.

### *Sugar production*

Factory performance continued to improve and the mill crushed at an increased average rate of 400 tons of cane per hour. Several new factory performance records were

established and record production of 247 000 tons of sugar was achieved. Enhancements to the factory operations were effected in the offcrop, and together with greater cane supplies, a further increase in sugar production in 2006/07 is expected.

### *Downstream*

Zambia Sugar produces a range of syrups and speciality sugars primarily for the domestic market. For the first time during the 2005/06 season, speciality sugars were also produced for supply into the EU market.

### *Marketing*

The domestic sugar market was very challenging during the year under review and sales were disappointing. Illegal imports impacted negatively on sales, which were below those achieved in the previous year. However, the company received good co-operation from the Government to counter the illegally imported sugar. In addition, the national marketing and promotional campaign was intensified and plans to improve rural distribution implemented. Zambia Sugar's EU preferential quota was supplied in full, including additional EBA quota awarded to Zambia for the period to June 2006 as a result of other LDC suppliers being unable to meet their country entitlements. Regional demand remained strong and prices firmed as the world price increased.



*Cane yields in Swaziland were much improved compared to the previous year, with increased sucrose content in the cane. Total estate cane production amounted to 802 000 tons.*

*Sugar production of 232 000 tons represented a 10% increase over that of last year, following a very successful milling season.*



## SWAZILAND

The group has a 60% share in Ubombo Sugar Limited, with the balance of shares held on behalf of the Swazi nation by Tibiyo Taka Ngwane. The operation is situated at Big Bend, in the south-east of the country and annually produces about 800 000 tons of cane and 230 000 tons of sugar.

### Agriculture

The Swaziland lowveld suffered from drought conditions during the past year, but the strong flow of the Usuthu River and good water management ensured that the cane crop at Ubombo was well maintained. Cane yields were much improved compared to the previous year, with increased sucrose content in the cane. In addition, harvesting and haulage operations were upgraded to meet the increased factory capacity demand. Total estate cane production amounted to 802 000 tons. Rainfall has been below average in the first part of 2006, however water supplies from the Usuthu River and the company's storage dams have been well managed and optimal irrigation of the crop has been achieved. Consequently, cane production in 2006/07 is expected to be similar to that of the past season.

### Sugar production

Sugar production of 232 000 tons represented a 10% increase over that of last year, following a very successful milling season. The factory crushed at consistently high rates and performance in all areas was much improved. A number of new performance records were established, with an increase in the average throughput rate to 400 tons of cane per hour for the season. Refined sugar output amounted to just over 100 000 tons. The bio-mass utilisation project and a much improved energy balance resulted in a significant reduction in coal consumption. Sugar production in 2006/07 is expected to be similar to that of the previous season.

### Marketing

All sugar produced in Swaziland is marketed by the Swaziland Sugar Association. Good domestic sales into the SACU market and normal sugar supplies to the EU preferential markets were made, whilst in terms of new quota allocations issued by the US Government, Swaziland was able to increase its US-bound exports during the season. The country also supplied regional markets, where prices firmed due to the increase in world sugar prices.

# REVIEW OF OPERATIONS CONTINUED



*Record sugar production of 137 000 tons was achieved at Kilombero during the past season.*



*Several projects financed by the company-supported Kilombero Community Trust Farm were initiated during the season, including the rehabilitation of approximately 20 kilometres of outgrower roads.*

## TANZANIA

Illovo's shareholding in Kilombero Sugar Company Limited represents 55% of the issued share capital, with 20% held by ED&F Man, the London-based commodities group, and 25% by the Government of Tanzania. Kilombero is situated in the Morogoro region in the centre/south of the country and comprises two adjacent agricultural estates and sugar factories on either side of the Great Ruaha River, strategically linked by a low-level bridge. Estate cane production has increased to more than 600 000 tons per annum, whilst sugar output has risen to this season's record of 137 000 tons.

### *Agriculture*

Very dry conditions in 2005 impacted negatively on cane yields and company cane production reduced to 525 000 tons, about 90 000 tons less than in the previous year. The use of new cane varieties, which have been propagated on site, in the estate replanting programmes has been yielding positive results. Support of outgrower development continued. Outgrower cane supplies to the factory increased from 588 000 tons in the previous season to around 700 000 tons as a result of an expansion of the area under cane. Several projects financed by the company-supported Kilombero Community Trust Farm were initiated during the season, including the rehabilitation of approximately 20 kilometres of outgrower roads. It has been very dry this summer in Tanzania and whilst good rains in February and April 2006 did much to revive the crop, it is

likely that increased estate area under cane and the benefits of the new cane varieties will be offset by the effects of the drought.

### *Sugar production*

Record sugar production of 137 000 tons was achieved during the past season. The operation of the plant however was disappointing and a number of performance-enhancing projects are being attended during the current offcrop. Good quality refined sugar was produced, but the absence of tariff protection for refined sugar producers remains a stumbling block to maximising production of such sugar. Given normal weather conditions, sugar production in 2006/07 is expected to be slightly higher than that of the previous season.

### *Marketing*

About 90% of sugar produced at Kilombero is sold domestically, with most of the balance sold to preferential markets in the EU. A small tonnage of sugar was sold into the regional market. In the domestic market, initiatives to improve rural distribution were undertaken. In addition to an overall rise in domestic sales, an increased offtake of the newly-introduced retail sugar pack was encouraging. Ongoing efforts are being made to establish tariff protection for refined sugar, an initiative which has support from the both the Sugar Board of Tanzania and the Tanzania Sugar Producers' Association.



*Factory performance at Maragra was most satisfactory in 2005/06, with mechanical and operational efficiencies being better than the previous year.*

*The agricultural operations performed well, resulting in cane production of 365 000 tons, which was a new record.*



## MOZAMBIQUE

The Illovo group holds a 76% share in Maragra Açúcar Sarl, with the balance held by a private investor. The operation is situated on the eastern coast-line of Mozambique, just north of Maputo. Both cane and sugar production have increased incrementally over the past five years to the current levels of around 370 000 tons and 75 000 tons respectively.

### **Agriculture**

The agricultural operations performed well, resulting in cane production of 365 000 tons, which was a new record. Cane yields showed a significant improvement and harvesting and haulage operations performed satisfactorily. The company also established 350 hectares of new cane land on behalf of a private grower. At full production, this will increase cane supplies to the factory by more than 35 000 tons. Efforts to further increase cane supplies to the factory continue and new land has been developed to provide seed-cane for new growers. The Mozambican Government recently approved plans for the construction of a new road which will provide access to a large area where farmers have shown keen interest in growing sugar cane. The company is assisting growers to access funding for their development projects although progress is frustratingly slow.

Favourable rains were received at Maragra during the summer and the crop has grown well. Good cane yields are projected, which should result in increased cane supply to the factory in 2006/07.

### **Sugar production**

Factory performance at Maragra was most satisfactory in 2005/06, with mechanical and operational efficiencies being better than the previous year. A number of new performance records were established. In addition, the factory generated and supplied electricity to the fields for irrigation, thereby minimising coal usage and electricity purchases. Maragra produced a record 75 000 tons of sugar. The good state of the crop and improved factory operations are encouraging factors for an increase in sugar production in 2006/07.

### **Marketing**

Domestic sales, which were similar to those of last year, were impacted negatively by the illegal importation of Zimbabwean sugar. Good co-operation, however, was received from the Mozambican authorities in countering these illegal imports. Preferential exports to the EU benefited from the additional EBA quota awarded to Mozambique as the result of other LDC countries being unable to meet their allocation for the year ending June 2006. Domestic and preferential market sales comprised 72% of total output for the year, which reduced exposure to the more volatile and lower-priced world and regional markets.

# REVIEW OF OPERATIONS CONTINUED

## TECHNOLOGY, RESEARCH AND DEVELOPMENT

The group continues to benefit from well-established in-house resources which provide technical expertise in both agricultural production and sugar and downstream product manufacture to all operations, in order to optimise the return from existing installed capacity. During the year, factories throughout the group were able to improve further on the mechanical and operational efficiencies achieved previously, with many plants operating at best-ever levels.

The group benefits on an ongoing basis from research and development undertaken by the South African Sugar Milling Research Institute, of which Swaziland, Malawi and Zambia are also members, and the South African Sugarcane Research Institute. These organisations are funded by the member sugar industries.

Illovo also has a dedicated team which pursues opportunities for the development and commercialisation of downstream products and new applications. In addition to its own resources, there is ongoing collaboration with both local and international research organisations and contract work is outsourced when appropriate.

## HUMAN RESOURCES

Human resource management and operational strategies are determined by the business needs of the group's operating entities with direction from the corporate office. These strategies appropriately embrace the macro-environment prevailing in each country and alignment is achieved through the group's strategic intent. The group's goals and objectives provide for the alignment of these strategies and bring about cohesiveness to the group. Underpinning this and ensuring that the operational strategies are met, is a work ethic of continuous improvement that embodies focused, skilled employees who are able to realise their full potential, 'make a difference' in their areas of operation and are challenged to go 'the extra mile'.

As a multi-national company with diverse and widespread senior management teams in several operating countries, regular communication forums and executive-led site visits are undertaken. This is reinforced through the group's Business Understanding Programme which all employees attend, promoting an understanding of the prevailing business climate at both operational and group levels.

Key areas of human resource focus include benchmarking; targeted manpower succession planning; performance management; the maintenance of collaborative industrial relations; human resource development and business understanding; BEE-linked employment equity and localisation programmes; and the health and welfare of employees and their dependants. To this end specific attention is given to -

- The staffing of all operations within effective organisational structures, with competent personnel both

from an operational and managerial perspective in order that goals and objectives are achieved. Complementing this, manpower benchmarking exercises have been carried out across the group, allowing for more accurate comparisons of operational effectiveness and manpower productivity to be determined;

- The development and retention of technical and leadership talent, continuing to place a high focus on manpower succession and career path planning, especially within the group's identified key disciplines and positions. During the year under review, existing employees filled 96% of all vacancies;
- Becoming the employer of choice in a skills market that is continually under pressure, requiring that remuneration packages are merit-based and market competitive in all countries of operation. Incentives such as performance-related bonuses, share purchase and phantom share schemes are presently utilised and are continually under review for their effectiveness;
- Ensuring that sound employee relations prevail. Trade union involvement is a normal part of this process and some 80% of permanent employees have membership of such unions. Collective bargaining forums, which determine the levels of wage rates and other substantive employment conditions have been established in all countries of operation. No time was lost through industrial action during the past year;
- Training and employee development which remains an important pillar for harnessing the group's human resource talent and potential. Activities are aimed at satisfying both the current and future business needs in terms of skills supply, whilst also supporting employment equity and localisation initiatives. The group invested approximately R19 million in this area over the reporting period, of which 44% was for technical-type training, whilst 38% was spent on management / supervisory and leadership development. Employee development initiatives include:
  - the building of employees' understanding of the prevailing business context within Illovo. Some 17 600 employees attended the group-facilitated Business Understanding Programme;
  - the continued development, refinement and implementation of performance management systems, along with ongoing technical competency training, which are linked to individual career pathing and operational excellence respectively;
  - the introduction of group-based management development programmes, aimed at both first-line and upper management;

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Relevant statistics in respect of designated employees, as defined in legislation, for the past two years, include –

Representative areas	% designated	
	2005	2006
Management level	51	<b>52</b>
Skilled level	83	<b>84</b>
Promotions (all levels)	93	<b>99</b>
External recruitments (all levels)	81	<b>93</b>
Promotions (management/skilled)	82	<b>96</b>
External recruitments (management/skilled)	61	<b>76</b>
Skills development initiatives (permanent employees)	89	<b>90</b>
Management trainees	87	<b>80</b>

Focus continues to be given to designated appointments in the more senior levels of management where there is shown to be an under-representation.

- group co-ordinated engineer-in-training and management trainee programmes presently involving some 150 trainees;
- the Training Outside Public Practice programme whereby graduate accountants may now carry out their traineeship within the company in order to obtain the academic qualification of Chartered Accountant (South Africa);
- The leveraging of operational best practice across the group.

#### **Employment equity**

The company promotes equal opportunity and fair treatment in employment through the elimination of unfair discrimination. It encourages inclusiveness with regard to human resource practices, irrespective of race, gender, nationality and religious affiliation.

In South Africa, the company's Employment Equity and Income Differential reports, covering progress made with the company's Employment Equity Plan, a key pillar of its BEE programme, were submitted to the Department of Labour and the Employment Equity Commissioner respectively. Progress continues to be monitored through a group Central Co-ordinating Forum that includes representation from local consultative forums which are in place at the various operations.

#### **Complement**

The group's overall permanent manpower complement as at 31 March 2006 stood at 12 886, representing a decrease of 11% from the previous year. The reduction in complement was mainly due to outsourcing, the sale of operations and restructuring. This was achieved by early retirements, voluntary redundancies and natural attrition. Employment was in the following categories -

- Sugar manufacture 6 708
- Agriculture 5 823
- Downstream 355

In addition, at peak periods during the year, approximately 23 300 seasonal employees were engaged in agricultural operations.

#### **Managed health care**

Access to health care is provided to all employees and their dependants either through the network of group-run primary health care clinics and hospitals or through the provision of medical insurance schemes. During the past year, there were approximately 550 000 visits to the group's health-care facilities. In support of the group's overall medical activities, the company attempts to ensure the health of employees and their dependants by addressing public health issues such as the provision of potable water and sanitation, where these are deficient.

# REVIEW OF OPERATIONS CONTINUED

The group continues to take a pro-active stance against life-threatening epidemics such as HIV/AIDS and malaria. These diseases are being managed, largely on a preventative basis, to negate their impact on the business and the employees themselves.

Strategies towards controlling the spread of HIV/AIDS include preventative awareness programmes along with an established Wellness Programme for those afflicted. These programmes continue to be developed in accordance with appropriate 'best practice' aligned to international standards. They involve high-profile education and awareness campaigns, effective treatment and prevention of sexually transmitted infections, use of peer counsellors in the process of preventative activities and education, voluntary counselling and testing, use of prophylactic antibiotics, effective screening for tuberculosis and the promotion of a healthy lifestyle.

Determining the impact of any HIV/AIDS intervention is difficult, largely due to the confidentiality restrictions with respect to the testing and recording of the disease. However, the company's commitment towards managing the effects of HIV/AIDS recognises the importance of voluntary counselling and testing, as it enables individuals to become aware of their HIV status, empowering people to act safely and responsibly, and is therefore key in controlling the spread of the disease. To this end, the company continues to campaign for employees to 'get to know your status'. People diagnosed as being HIV positive are encouraged to join the voluntary Wellness Programme.

Government interventions relative to the provision of anti-retroviral (ARV) drug therapy are being closely monitored in all countries of operation. Where the company is being asked to assist in the process, it is particularly important to ascertain the long term sustainability of intended programmes and the role that the government medical facilities are expected to play -

- In South Africa, formal facilitation partnerships are being developed with those local government hospitals designated as HIV ARV treatment centres, to allow employees and dependants on the company's Wellness Programme to be bridged into the government ARV programme as and when their status for this treatment is medically necessitated;
- In Malawi, the company has begun to assist in implementing the government-funded ARV therapy programme at its mill-based medical facilities.

In respect of malaria, the group subscribes to the African continent's recognised 'Roll Back' malaria programme, and mosquito control spray programmes continue to be carried out in areas most affected. This, together with established laboratory testing facilities to enable early detection, are having an encouraging impact with a further reduction in the number of positive cases being reported to the group's health care facilities.



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*Where appropriate, the facilitation of employee home ownership has continued, thereby allowing employees to have a stake in the community within which they live and work.*



## **Employee benefits and welfare**

The group offers a diverse range of benefits to its employees, including -

- Employee share purchase schemes in countries where the operating company is listed, enabling employees to acquire a stake in the business;
- Retirement funding schemes, where elected employee trustees representing the interests of members assist with the prudent management of various funds;
- Educational assistance which is extended to the children of employees in various forms, ranging from the provision of schools to the allocation of bursaries, grants and loan funding;
- Upliftment of life skills of employees through the provision of Adult Basic Education and Training (ABET), retirement planning, HIV/AIDS education and counselling.

Where appropriate, the facilitation of employee home ownership has continued, thereby allowing employees to have a stake in the community within which they are living and working. This involves the sale of company-owned houses as well as other efforts to assist home ownership including the provision of home loan subsidies.