

# Review of operations



Graham Clark

## OVERVIEW

Whilst financial performance was generally good during the past year, production across the group was variable. Record cane and sugar was achieved in Malawi, and sugar output continued to increase in Mozambique. In South Africa, Illovo's share of industry sugar production increased, whilst less sugar was produced in Swaziland, Tanzania and Zambia compared to last year. The downstream operations in South Africa performed very well, including record lactulose production being achieved at Merebank and the Sezela downstream plant operating ahead of expectations. A highlight during the year was the completion of the major capacity expansion in Zambia, as planned, on 1 April 2009.

Domestic sugar markets remain the group's most important outlet and very good volume growth, coupled with well-timed price adjustments, drove domestic market sales performance to new highs. Advantage was taken of the evolving new market access arrangements into the European Union (EU) and export revenue was also boosted by firm regional pricing and world sugar prices which continued on an upward trend. Export demand for the group's downstream products was strong and prices were higher than anticipated throughout the year. Effective cost control remained critical to improving operating margins for the year.

Group cane production was driven by higher yields in Malawi and Zambia, offset by the impact of dry weather conditions which negatively affected crop growth in South Africa, Swaziland, Tanzania and Mozambique. Overall, the agricultural operations performed well, with record cane production achieved at both estates in Malawi, and increased sucrose content recorded in all countries of operation except South Africa. Cane production across the group amounted to 5.1 million tons for the year. During the past season, additional irrigated cane land was developed in Malawi and in Zambia as part of the expansion programme. In Swaziland, a project to convert under-performing areas to

centre-pivot irrigation was commenced as part of a broader initiative to upgrade irrigation systems and increase future cane yields.

Aggregate sugar production, including Umfolozi which has now been sold, amounted to 1.824 million tons for the year, compared to 1.792 million produced last year. Factory performance in Malawi and Mozambique was excellent, with a number of production-related records achieved by these operations, whilst disappointing factory performance in Zambia had a negative impact on overall group sugar production. The raw sugar factories in South Africa also performed well. During the past offcrop period, the Nchalo mill in Malawi was further expanded to accommodate increased cane supply from recently developed cane fields, as was the Maragra mill in Mozambique as the first part of a phased capacity expansion project in advance of projected increased cane availability from a number of new irrigated cane developments. It is pleasing to note that since the commencement of the 2009/10 season, the performance of the newly expanded factory in Zambia has continually improved which augurs well for the coming year.

Domestic sugar sales in Malawi, supported by effective rural distribution and ongoing marketing initiatives, reached a new high during the past year, ending 11% above the previous season. Local market sales in Mozambique continued to grow and increased by 8% compared to last year's record, whilst those in South Africa increased by 6%. Domestic sales of sugar from Swaziland into the South African Customs Union (SACU) region also increased to new levels year-on-year. In Zambia, domestic market sales were constrained by lower production but still recorded growth of 2% to also reach a new high. Local sales in Tanzania were steady throughout the year and stable market conditions assisted sales generally. Local market prices across the group were maintained at levels that effectively countered inflation in each country of operation.



1. *The agricultural operations performed well, with record cane production achieved at both estates in Malawi, and increased sucrose content recorded in all countries of operation except South Africa.*
2. *Domestic market sales improved across the group, most notably in Malawi, Mozambique and South Africa whose local sugar offtake compared to last year increased by 11%, 8% and 6% respectively.*
3. *Factory performance in Malawi and Mozambique was excellent, with a number of production-related records achieved by these operations, whilst the raw sugar factories in South Africa also performed well. Total sugar production amounted to 1.824 million tons.*

Export sales revenue grew by 9% in 2009/10, due to higher average world and regional market prices during the year. The group also benefitted from preferential premiums for tonnages sold into the EU which granted the last tranches of increased quota to Least Developed Countries (LDC's), including Malawi, Mozambique, Tanzania and Zambia, before the advent of unrestricted EU market access in October 2009. Favourable quota re-allocations made available by other quota holders not being in a position to supply to the EU market also improved export sales. Export logistics and volatile freight rates were well managed and good Euro premiums were earned. Regional export demand remained buoyant and pricing reflected tight supply conditions resulting from lower production in Zambia and Zimbabwe, together with firm world market prices. World market exposure in South Africa was generally well-hedged against a rising world market price. Revenue benefits also arose from favourable currency weakness during the year.

Rising costs of production were a challenge during the past year as all operations faced escalating costs in respect of fuels, fertilisers, packaging, steel and other inputs that were affected by the general surge in commodity pricing early in the year. Stringent cost control and timeous pricing as commodity values fell during the latter part of the year enabled operating cost to be well controlled across the group. This, combined with a strong revenue performance,

sustained the group's growth in operating profits and enabled the operating margin to strengthen year-on-year.

All three downstream plants in South Africa operated well and good factory performance was maintained throughout the season. Against the background of a global product shortage in 2008, furfural and furfuryl alcohol prices were driven to new levels, whilst Merebank achieved record lactulose production and export sales. Export alcohol sales also benefited from higher international prices.

Total capital expenditure in 2008/09 amounted to R1 866 million, of which expansion capital for projects aggregated R1 697 million. 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 global standards.

### **STRATEGIC REVIEW**

The group's goals and objectives are detailed on page four of this report. Progress towards achieving these targets is monitored on a regular basis through performance reviews and strategic assessments, which take account of ongoing developments both within and outside of the organisation. Interventions are made through the processes of medium-term strategic planning and annual budgeting for capital and operating expenditure. The group's primary objectives

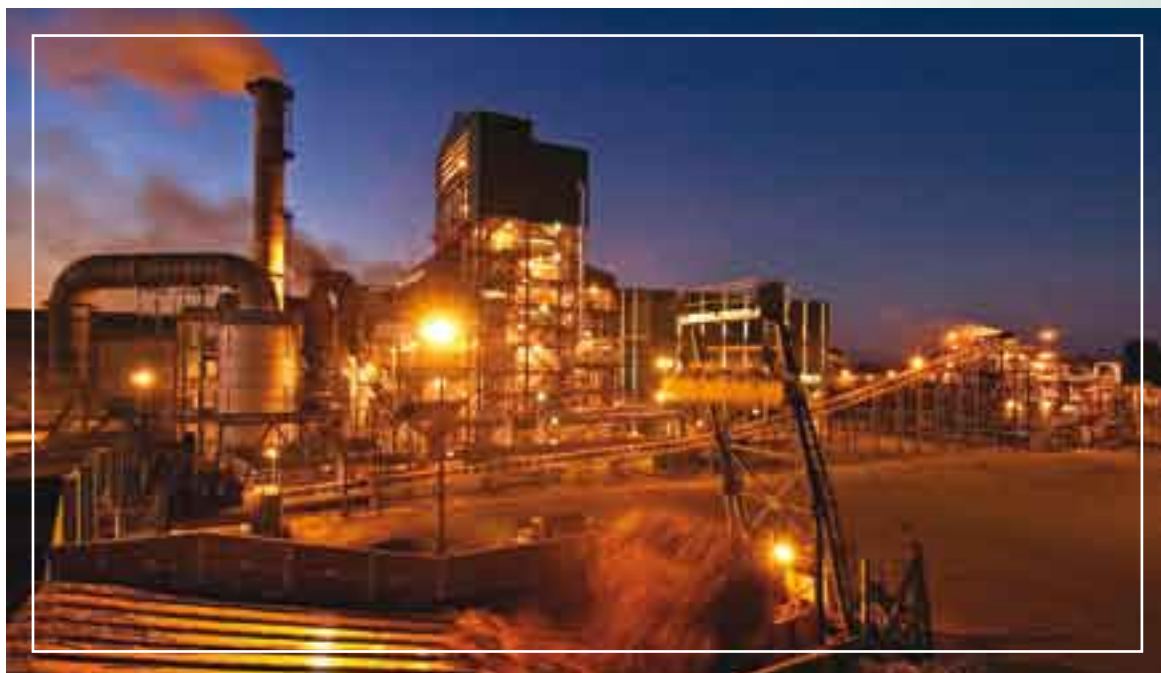
# Review of operations continued

of enhancing shareholder wealth, being world-class and an efficient, low cost producer, whilst achieving a balanced and integrated economic, social and environmental performance, have largely been achieved over the past five years. The share price has risen over this period on a compounded basis by some 29% per annum and during the past year, outperformed its peer groupings on the JSE Limited. Production growth has been significant since the group first embarked on its expansion outside South Africa and strong cash flows have been maintained enabling dividends to be paid consistently, twice covered by annual earnings. The development and commercialisation of downstream products remains ongoing and the group's commitment to employee development and equal opportunity is strong. High standards of corporate governance are demanded from all group operations and compliance is regularly reviewed.



*All three downstream plants in South Africa operated well and good factory performance was maintained throughout the season.*

*The major expansion of Zambia Sugar was completed as planned on 1 April 2009. In addition, the group has, subject to approval by the Zambia Competition Commission, acquired a majority stake in Nanga Farms PLC, a cane growing company which currently produces 325 000 tons of cane per annum.*



The group strives to achieve and surpass its goals and objectives on an ongoing basis, guided by the principles incorporated within the group strategic intent. All entities within the group are aligned to Illovo's common goals and objectives, and annual strategic plans and budgets are prepared with these aspects in mind. Company culture endeavours to ensure that the expectations of all stakeholder communities are addressed on an ongoing basis.

## **Growth philosophy**

The group continues to consolidate its South African operations, recognising the potential for superior returns elsewhere in Africa. Accordingly, the group seeks to establish a profitable, stand alone South African entity with the capacity to maintain acceptable group returns. Major investment outside South Africa will be undertaken in areas that display positive and stable social, political and economic fundamentals, have adequate water and land resources, favourable climatic and agronomic conditions, strong local sugar markets and good export potential.

## **Strategic update**

In line with the above philosophy, the following initiatives have either been completed or are underway :-

### **SOUTH AFRICA**

- ◇◇ The sale of the Umfolozi sugar mill to a grower consortium has been completed effective 31 March 2009, with payment received in full;
- ◇◇ An agreement to sell the Pongola sugar mill to TSB Sugar RSA Limited has been concluded, subject to approval by the Competition Commission;
- ◇◇ The company has acquired a 30% shareholding in and will provide technical services to a new business

entity which has purchased the Gledhow sugar mill unencumbered, previously wholly-owned by Ushukela Milling (Pty) Limited (Ushukela). The other shareholders in this new business entity comprise Ushukela, a consortium of supplying cane growers and Sappi Manufacturing (Pty) Limited;

- ◇◇ The company plans to transfer its remaining South African business to a wholly-owned subsidiary with effect from 1 April 2010.

#### MOZAMBIQUE

- ◇◇ The group has entered into a joint venture with the local community at Maragra to develop 4 000 hectares of land to cane over the next two years at a site located on the east bank of the Inkomati River approximately 40 kilometres from the Maragra sugar mill. The joint venture will produce 400 000 tons of cane per annum and the project is linked to the doubling of the capacity of the Maragra factory, to 150 000 tons of sugar per annum;
- ◇◇ The company has acquired an option to purchase a 90% shareholding in the Búzi sugar estate situated near Beira, which provides the opportunity to erect a sugar factory in this area in the future.

#### ZAMBIA

- ◇◇ The final phase of the major expansion project, which increases the capacity of the Nakambala sugar mill to 450 000 tons of sugar per annum, was completed as planned on 1 April 2009;
- ◇◇ The group has, subject to approval by the Zambia Competition Commission and other regulatory authorities, acquired a majority stake in Nanga Farms PLC, a cane growing company, located adjacent to the Nakambala estate, and currently producing

325 000 tons of cane per annum. Nanga has the potential to further increase cane production. This operation delivers its cane to the Nakambala sugar mill.

#### SWAZILAND

- ◇◇ Expansion of the Ubombo factory to increase sugar production to in excess of 300 000 tons per annum is being progressed, linked to the completion in early 2009 of a major new dam and canal system funded by the EU and Swaziland Government, which will facilitate expansion of cane growing in the area. The new area under cane is likely to cover some 5 000 hectares of land in the medium-term, with further potential for development available in the longer-term.
- ◇◇ Associated with the factory expansion, plans are underway to increase power generating capacity at Ubombo utilising biomass, in the form of residue leaves and tops from harvested cane, as supplementary fuel for the factory boilers. This will enable the factory and surrounding estates to be self-sufficient in electricity for 48 weeks of the year and also provide the ability to export power into the national grid.

#### MALI

- ◇◇ The proposed greenfields project in Mali is progressing in pre-project mode. Necessary financial approvals are expected by November 2009 and thereafter cane development will commence in the first half of 2010. Construction and commissioning of a new factory is anticipated by December 2011.
- ◇◇ The Malian operation will ultimately produce 195 000 tons of sugar and 15 000 kilolitres of ethanol for fuel blending, and generate sufficient electricity for the agricultural and factory operations, with additional capacity to export power into the national grid.



*In Swaziland, the completion of the Lubovane Dam under the auspices of the Lower Usuthu Smallholder Irrigation Project will facilitate major expansion of cane growing in the area. As a consequence, the expansion of Ubombo's productive capacity to in excess of 300 000 tons of sugar per annum is being progressed.*



Karin Zarnack

## FINANCIAL REVIEW

### Group Performance

Group revenue increased by 27% from R6 794 million to R8 602 million in the current year and operating profit increased by 30% to R1 386 million. This was achieved mainly by the continued growth in domestic market sales, higher world and regional sugar prices and weaker exchange rates. Aggregate operating margins were slightly higher at 16.1% (2008: 15.7%).

Net financing costs of R184 million were slightly higher than last year's R170 million. This increase resulted from the group's continued capital investment in projects at all its operations, together with the increase in the cost of funding. The interest cover has however improved to 7.5 times (2008: 6.2 times).

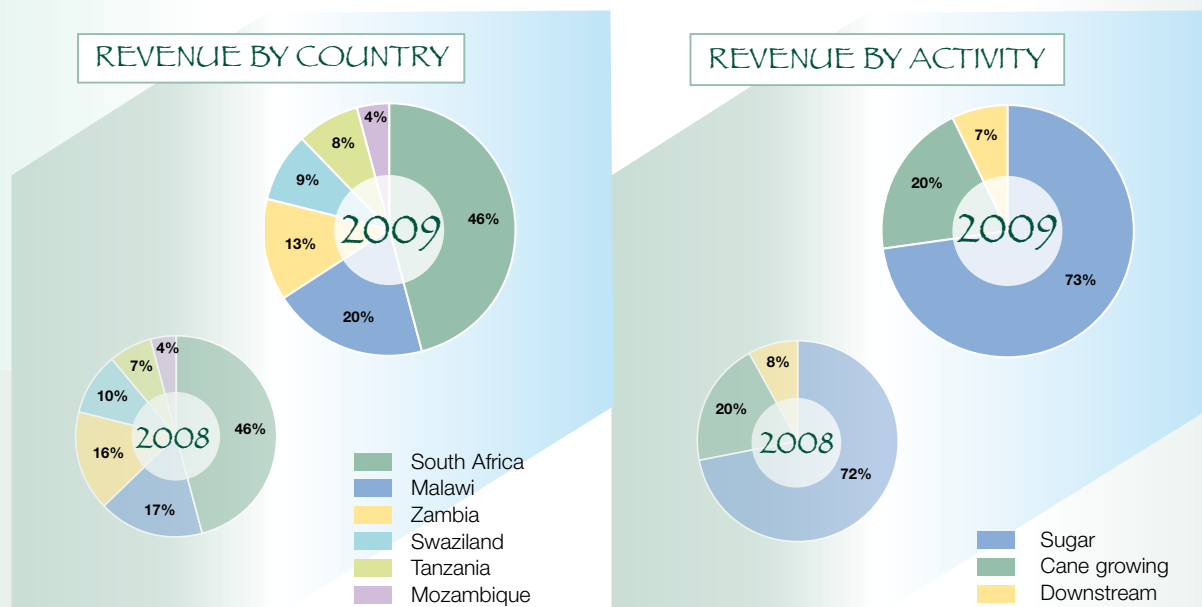
The tax charge of R239 million included current tax of R196 million, deferred tax of R10 million and secondary tax on companies of R33 million, resulting in an effective tax rate of 19.9% for the year. This is still lower than the average statutory tax rate due to expansion-related tax allowances granted to the Zambian operations.

### Earnings and dividends

Headline earnings have increased by 24% to R742 million (2008: R600 million) and the weighted average number of shares in issue has increased slightly from 349.4 million to 350.5 million. Headline earnings per share increased by 23% from 171.6 cents to 211.6 cents.

An interim dividend of 41.5 cents was paid and a final dividend of 64.5 cents has been declared which represents an overall increase of 24% for the year. In accordance with

## SEGMENTAL ANALYSIS



International Financial Reporting Standards, no liability has been raised for the final dividend, however the cost of the proposed dividend of R226 million has been transferred from retained surplus to a separate dividend reserve. The strength of the balance sheet and results achieved have made it possible to maintain the dividend at twice covered by earnings.

### Balance sheet

Shareholders' equity increased from R2 373 million to R2 774 million. Return on average shareholders' equity was 29% (2008: 30%). This slight decline is largely as a consequence of the level of investment made this year in capital projects which have yet to yield a return, as well as the lower profitability of the Zambian operations.

Non-current assets increased by 37% to R5 370 million which included property, plant and equipment of R4 088 million and cane roots of R1 132 million. This increase is mainly due to the completion of the factory and agriculture expansion in Zambia.

Net borrowings at year-end were R1 243 million higher than last year at R2 411 million reflecting expansion projects invested in during the year. Debt : equity increased from 40% to 70% in the current year.

### Cash flow

The group continued to achieve strong cash operating profit of R1 207 million, compared to R1 055 million last year. Better working capital management resulted in a cash inflow of R363 million for the year. Major investment in the group's expansion projects resulted in cash outflows of R1 697 million with R170 million spent on replacing existing property, plant and equipment. Other cash outflows included taxation of R230 million, dividends of R449 million and finance costs of R184 million. This resulted in cash outflow before financing activities of R1 127 million.

### Financing

At year-end, the group had total committed bank facilities amounting to R2 699 million of which R2 364 million was drawn-down. R1 386 million of these facilities expire within the next year with the remainder maturing between 2011 and 2015. The group also had access at year-end to uncommitted facilities of R2 580 million of which R47 million was drawn-down.

A treasury risk management committee, consisting of senior executives in the group, meets regularly to analyse currency and interest rate exposure and formulates treasury management strategies in the light of prevailing market conditions and current economic forecasts. This committee operates within group policies approved by the board. Forecasts have been prepared which take into account the group's capital commitments, available facilities and cash resources, and this still indicates a strong liquidity position over the medium-term.

### Foreign currency exposure

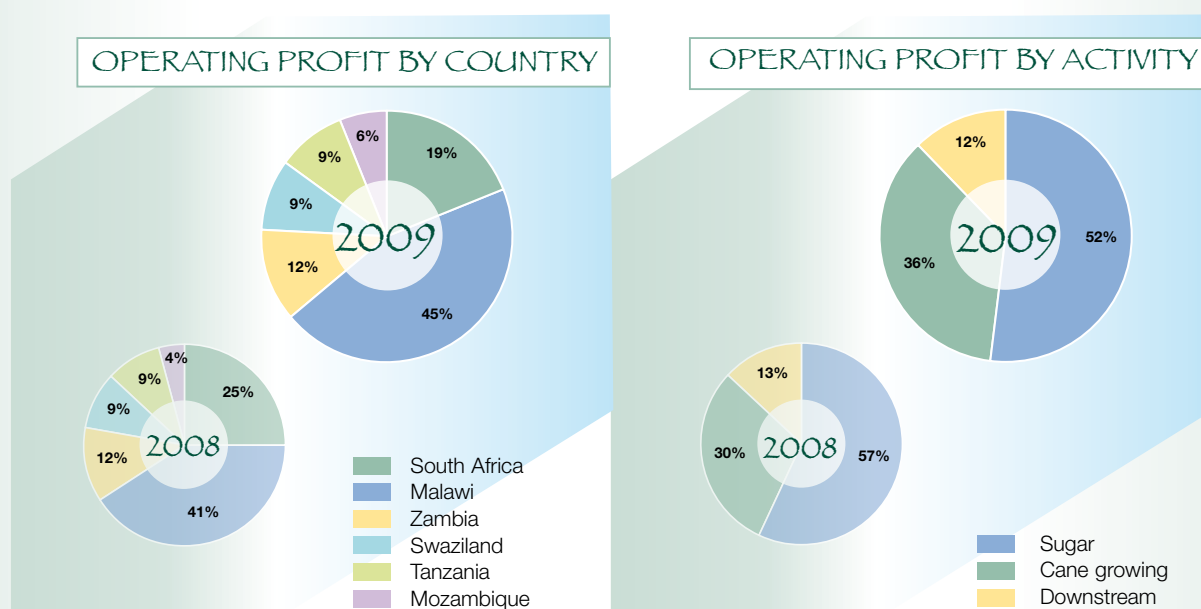
In the normal course of business, the group enters into transactions denominated in foreign currencies and hence is exposed to fluctuating exchange rates. Exchange rates exposures are managed within approved policy parameters utilising forward exchange rates.

At year-end, the company had a US\$120 million loan from its holding company. In order to minimise the interest rate and exchange rate risk on this loan, the company entered into a three-year cross-currency interest rate swap which fixes the exchange rate on the capital and swaps out the LIBOR interest rate to a Rand-based JIBAR interest rate.

### Accounting policies

The annual financial statements comply with International Financial Reporting Standards, Schedule 4 of the Companies Act, 1973 and the disclosure requirements of the JSE Limited's Listings Requirements.

The accounting policies are consistent with those applied in the prior year.





*Cane production in South Africa in 2008/09 amounted to 464 000 tons.*

## OPERATIONS

### SOUTH AFRICA

Illovo is South Africa's largest sugar producer, with its operations strategically located across the eastern section of KwaZulu-Natal. The operations presently consist of three agricultural estates, five sugar factories, two of which incorporate refineries and three downstream plants all of which are wholly owned by Illovo. Currently, annual cane production by Illovo amounts to approximately 450 000 tons and together with cane supplied by private growers, approximately 900 000 tons of sugar are produced annually. Furfural, furfuryl alcohol, Agriguard products, diacetyl, 2,3-pentanedione, ethyl alcohol and lactulose are produced at the various downstream plants.

#### *Agriculture*

Cane production in 2008/09 amounted to 464 000 tons. Cane yields at Sezela and Umzimkulu were impacted negatively by below average rainfall for most of the season, whilst those at Eston showed a slight increase over the previous season. There was a reduction in sucrose content across all three areas.

Cane supplied by medium-scale Black cane growers increased in 2008/09 by 11% to 425 000 tons. Deliveries from small-scale growers amounted to 438 000 tons, including cane deliveries by small-scale growers at Umfolozi. The company provides ongoing support to the small-scale grower sector, and cane re-development initiatives continued at Sezela and Umzimkulu, co-ordinated by Illovo and local cane growing associations. At Umzimkulu, 340 hectares of land has been developed with forecast deliveries by

small-scale growers of 17 000 tons of cane in 2009/10, increasing by a further 3 000 tons in the following season. At Sezela, 460 hectares of land was planted to cane with approximately 14 000 tons of cane to be delivered in 2009/10.

To date, of the total land area supplying cane to Illovo mills, 55% has been the subject of land claims in terms of the Restitution of Land Rights Act. Thus far, of the areas claimed, only 9% has been transferred to claimants. The company is working with the affected growers, the claimants and the relevant Government authorities to ensure that farms transferred in terms of the restitution process continue to be cultivated productively.

#### *Sugar production*

The raw sugar mills experienced successful seasons with good overall recoveries of sugar from cane and high levels of factory efficiency achieved at Sezela, Umzimkulu, and at Eston, which also recorded improved cane throughput levels. However, factory and refinery performance at Pongola and Noodsberg was disappointing, with operating difficulties affecting production at both factories during the season. Remedial action to address these performance issues was undertaken during the offcrop period. Including Umfolozi, total sugar production amounted to 922 000 tons. Illovo's share of industry production increased from 38% to 41% in 2008/09.

*The raw sugar mills experienced successful seasons with good recoveries of sugar from cane. High levels of factory efficiency were achieved at Sezela, Umzimkulu and Eston, which also recorded improved cane throughput levels. Total production amounted to 922 000 tons.*



*The company provides ongoing support to the small-scale grower sector, and cane re-development initiatives continued at Sezela and Umzimkulu during the year, resulting in increased cane supplies from these growers.*

Widespread rains were received at the beginning of 2009, providing good conditions for cane growth. However, generally drier conditions in March and April have impacted upon the cane crop and therefore sugar production is expected to be only slightly higher than last year, excluding Umfolozi.

#### *Downstream*

The furfural plant operated well throughout the season with a marginal increase in production compared to last year. Improved furfural yields largely offset the negative impact of reduced cane supplies to the Sezela factory. Both alcohol distilleries at Merebank and Glendale continued to perform well, and maintained consistent quality and good throughput levels throughout the year. Record lactulose production was achieved at Merebank with the plant having benefited from the expansion of its operations during the season.

#### *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. In 2008/09, Illovo's overall domestic market sales of sugar increased by 6%. The group remains the major supplier of sugar to the South African industrial market and increased sales to this sector were achieved during the year under review, particularly to soft drink manufacturers. Retail market sales were strategically reduced due to the presence of

significant quantities of duty-paid imports in this sector of the domestic market. Regional market sales into SACU, which were traditionally supplied by Zimbabwe, increased during the year due to that country's current sugar production difficulties.

Illovo's share of raw sugar exports to the world market, undertaken by SASA, amounted to 335 000 tons for the year. The average price realised by the industry, including hedging activities undertaken by SASA, was US12.77 cents/lb, representing an increase in price compared to the previous year's lower level, due to the higher average world market price experienced during 2008/09. In respect of the 2009/10 season, around 350 000 tons of world market sugar have been priced to date on behalf of the industry by SASA, at an increased average price of US14.69 cents/lb.

The downstream operations enjoyed a very successful performance in 2008/09. Strong global demand for furfural and furfuryl alcohol, combined with China's restricted production as the result of increased manufacturing costs in the first half of the year, drove international furfural prices to record highs. Whilst prices in the first quarter of 2009 have since fallen, the impact on Illovo in the year under review was marginal, with the majority of the company's production already having been committed and sold by this time. In addition, export alcohol prices were good, whilst the lactulose business capitalised on record production to supply



*The downstream plants performed well throughout the year, with record production being achieved at the newly expanded lactulose plant at Merebank.*

increased export volumes at a time of very strong demand, thereby benefiting from higher international prices.

The Agriguard business continued to expand gradually as further regulatory access was gained during the season and sales into new markets and for new crops commenced. In South Africa, Crop Guard achieved registration for use on tobacco crops, whilst registrations for its use on grapes and deciduous fruit are presently being reviewed by the Department of Agriculture. MultiGuard Protect remained under review at the USA Environmental Protection Agency in respect of its use on terrestrial non-food applications. A similar application has been submitted to the United Kingdom Pesticide Safety Division for MultiGuard Protect's access to the UK and European Markets. BioMass Sugar, a liquid organic fertiliser derived from sugar cane, showed good initial international growth during 2008/09, and expansion and sales into new geographic locations is expected to continue during the 2009/10 year.



*A combination of ideal weather conditions, increased cane yields and higher sucrose content in cane contributed to excellent agricultural performances at both Nchalo and Dwangwa. Combined cane production amounted to 2.1 million tons.*

## MALAWI

Illovo Sugar (Malawi) Limited is Malawi's sole sugar producer with two operating locations, Dwangwa situated in the centre of the country and Nchalo in the south. On average, the two estates together produce more than two million tons of cane from fully irrigated fields and around 300 000 tons of sugar. Both mills have refineries, and speciality sugars are produced at Nchalo. 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.

Both Nchalo and Dwangwa have been the focus of various agricultural and milling capacity expansion projects. At Dwangwa, factory capacity was increased by 15% and new areas of company and outgrower land continued to be developed to cane, through which cane supplies to the Dwangwa mill will increase by about 110 000 tons per annum. At Nchalo, 720 hectares of new land were developed to cane in the past year and a further 480 hectares will be developed in the coming year. Factory capacity at Nchalo was increased during the past offcrop period by 10% in order to accommodate the increase in future cane supply. The production of cane by Malawian local indigenous farmers continues to gain momentum and areas being farmed by outgrowers at both Nchalo and Dwangwa are expanding. The Kasinthula small-grower scheme, which currently supplies cane to the Nchalo mill, became the beneficiary of a wide-ranging support package from the EU, including the provision of management services



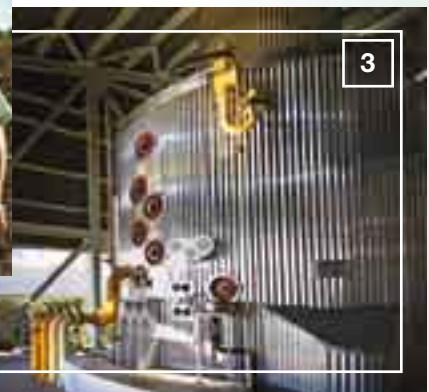
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1. Both Nchalo and Dwangwa have been the focus of various agricultural and milling capacity expansion projects with the factories having recently been expanded by 10% and 15% respectively.

2. The production of cane by Malawian local indigenous farmers at both estates continues to gain momentum and during the year the Kasinthula small-grower scheme, which currently supplies cane to the Nchalo mill, became the beneficiary of a wide-ranging support package from the EU.



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3. Record production of sugar was achieved at both the Nchalo and Dwangwa factories, resulting in a production record of 304 000 tons for Malawi.

and financial backing for an expansion of this scheme by a further 500 hectares. The African Development Bank remains a major concessional funder and supporter of outgrower initiatives at Dwangwa.

*Agriculture*

A combination of ideal weather conditions, increased cane yields and higher sucrose content contributed to excellent agricultural performances at both Nchalo and Dwangwa. Combined production of cane from the two estates amounted to 2.1 million tons. Harvesting and haulage operations ran smoothly throughout the season and were completed ahead of the onset of summer rains. Post-harvest activity and general crop husbandry has been of a high standard and another very good cane crop is expected in the coming season. Combined outgrower production in 2008/09 increased slightly to 209 000 tons.

*Sugar production*

Record production of sugar was achieved at both the Nchalo and Dwangwa factories, resulting in a production record of 304 000 tons for Malawi. The factories performed well throughout the season, and in addition to good recoveries of sugar from cane, a new annual cane throughput record was set at Dwangwa. Nchalo completed a very successful year, with record recoveries of sugar from cane, good throughput and very good operating efficiencies.

Both estates received abundant rainfall during the first quarter of 2009. This rainfall, interspersed with hot sunny periods provided excellent growing conditions which, combined with increased cane deliveries from recently completed estate and outgrower developments, will increase cane production in the coming year. Sugar production is therefore expected to increase further in 2009/10.

*Marketing*

The Malawian economy enjoyed another year of strong growth, increased domestic demand and improved purchasing power, stimulated by good agricultural production throughout the country. Against this background, record domestic sales volumes were sustained throughout the year. Compared to last year, overall domestic market sales increased by 11%, supported by effective rural distribution and ongoing company marketing initiatives. Continuation of an incentive programme amongst sugar agents and distributors proved highly successful, evidenced by good sales through to the end of the season. Preferential exports to the EU and USA continued to benefit from improved transport logistics to the ports of Beira and Nacala in Mozambique, and efficient handling at both ports enabled record volumes to be shipped. There was strong demand for sugar throughout the region as a result of general market shortages and prices were higher than last year.

# Review of operations continued

## ZAMBIA

Zambia Sugar Plc, which is listed on the Lusaka Stock Exchange, is the country's leading sugar producer, with an 87% share of industry production. The Illovo group owns 90% of the issued share capital, with the remaining shares held by private and institutional investors. Zambia Sugar has announced a rights offer, to secure the future funding of business. The operation is based at Nakambala, adjacent to Mazabuka in the south of the country. Zambia Sugar syrup and speciality sugars are also produced.

The major phased expansion at Zambia Sugar, involving the development of an additional 10 500 hectares of irrigated cane fields by the company and its supplying growers, and the expansion of the factory's milling capacity to increase annual sugar production to around 450 000 tons, was successfully completed, as planned, on 1 April 2009. Given normal operating conditions, it is forecast that in the coming year, combined cane production by the company and the growers will increase to 3.3 million tons, whilst sugar production will more than double from the current base.

The past year has been a difficult one with poor factory performance and an exceptionally wet end to the season negatively affecting operations. The result was a decline in sugar production of around 40 000 tons. A significant area of cane could not be harvested before the early onset of the summer rains and the factory was re-started in March 2009 to process some of this cane ahead of the new season. The newly expanded factory is settling down well and a much better year is anticipated.

### *Agriculture*

Good agricultural conditions were experienced for most of the growing season, and average cane yields increased by 14%. However, the early onset of heavy summer rains in mid-November disrupted harvesting and haulage activities to such an extent that the season was ended earlier than anticipated. Total cane deliveries from the Nakambala estate amounted to just over 722 000 tons, whilst outgrowers delivered a further 903 000 tons in what was best described as a disrupted season.



*In Zambia, good agricultural conditions were experienced for most of the growing season, and average cane yields increased by 14%. However, cane deliveries of 722 000 tons were constrained by the early onset of heavy rains.*

*Sugar production for the year amounted to 194 000 tons, with factory operations impacted negatively by heavy rains, and operational and mechanical problems during the season. However, since the commencement of the 2009/10 milling season, the newly expanded factory is settling down well and a much better year is anticipated.*



### *Sugar production*

The late commissioning of the first phase of the expansion project in May 2008, following unusually heavy rainfall at the peak of construction in January and February 2008 delayed the start of the 2008/09 season. Sugar production for the year amounted to 194 000 tons, with factory operations impacted negatively by operational and mechanical problems during the season. This was compounded by late commissioning of new equipment and protracted electricity interruptions from the national grid, and also by wet weather at the end of the year which brought factory operations to a premature close. Factory operations re-commenced for a short milling period in March 2009.

In the forthcoming season, a very large cane crop is expected as a result of the expansion and the carry-over of cane which could not be harvested last season.

### *Marketing*

Domestic market sales, supported by better distribution and promotions, continued to show growth with a 2% increase in sales volumes compared to last year. Ongoing support from the Government to curtail the illegal entry of imported sugar into Zambia also supported domestic volumes. Preferential exports to the EU were constrained by lower production, although all EU quota entitlements were retained for the year. Zambia has received additional EU quota for the coming year, following the re-allocation of quota that could not be supplied by other country-suppliers, together with additional quota awarded to Zambia following its accession to the new Economic Partnership Agreement with the EU. This will provide the opportunity to accelerate EU exports at the commencement of the 2009/10 season, ahead of the final price cut in the EU on 30 September 2009. Duty-free and quota-free market access from 1 October 2009 will provide a secure destination for all available sugar thereafter. Regional export volumes were affected by reduced production. Sugar availability in the region was also affected by lower production in Zimbabwe and prices have remained firm, providing good prospects for the coming season.



*In line with the group's objective to become self-sufficient in power requirements, the electricity generating capacity of the Nakambala factory has been increased to the extent that it is now capable of producing enough electricity for all of its agricultural and factory activities.*

## 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 (Tibiyo). The operation is situated at Big Bend, in the south-east of the country and annually produces about 775 000 tons of cane and 220 000 tons of sugar.

Completion of the Lubovane Dam, which is now filling and currently at 75% of its water-holding capacity, and the scheduled planting from September 2009 of the first area of new small-holder land to irrigated cane, are major steps forward in the future expansion of the Ubombo factory, underpinned by the independent Lower Usuthu Smallholder Irrigation Project (LUSIP). The LUSIP project involves the establishment of up to 12 000 hectares of irrigated agricultural land over a period of six to seven years, a large proportion of which will be developed to cane and delivered to the Ubombo factory where milling capacity is to be increased to match future cane development. Under the current development plans, it is envisaged that an additional 1 900 hectares of cane will be available for milling at Ubombo by the 2011/12 season, growing to 5 000 hectares thereafter and ultimately up to 9 000 hectares of cane in the longer-term. Proposals to increase the Ubombo factory capacity by over 20% to accommodate the increased cane supply are being undertaken.

### Agriculture

Estate cane production at Ubombo in 2008/09 amounted to 740 000 tons. A further one million tons of cane was produced by outgrowers, including nearly 230 000 tons from an area owned by Tibiyo but managed by Ubombo. Aside from early rains at the commencement of the season, the agricultural operations were characterised by exceedingly dry weather which impacted negatively on cane yields.

This was offset slightly by increased sucrose content. A project to convert a portion of Ubombo's irrigation to centre pivot has made good progress with approximately 680 hectares of cane land converted to centre-pivot irrigation during the season. A total of 2 740 hectares of land will be converted under this project, with the primary aim being to improve water usage at Ubombo and to increase cane yields. Results from the first phase were most encouraging.

### Sugar production

A reduced cane crop from Ubombo's own estates and the supplying growers resulted in sugar production for the year of nearly 210 000 tons, compared to 222 000 tons produced in the previous season. Sugar recoveries were similar to last year, but production was impacted negatively by outgrower cane supply delays and industrial action which affected a large independent cane haulier towards the end of the season. The factory also encountered several other operating difficulties during the season which have been addressed in the offcrop maintenance period. Ubombo continued to pioneer use of biomass - residue cane tops and leaves, combined with bagasse which is used by the factory to generate electricity. The initiative impacted positively on coal usage and costs, and will be further expanded in order to potentially make Ubombo self-sufficient in terms of power requirements, and also enable the export of electricity to the national grid.

Above average rains received in the first quarter of 2009 have replenished soil moisture profiles in Swaziland and lifted significantly the levels of Ubombo's two major irrigation storage dams. Conditions for cane growth have generally been good and a bigger cane crop is anticipated in the coming year. A slight increase in sugar production in 2009/10 is therefore expected.



*In Swaziland, additional agricultural activities during the year included the establishment of seed cane plots to facilitate the small-scale grower cane development objectives of LUSIP, together with the conversion of a portion of Ubombo's existing cane land to centre-pivot irrigation to improve cane yields.*



*Sugar production in 2008/09 amounted to 210 000 tons. A new sugar drier was installed at Ubombo during the year.*

### Marketing

All sugar produced in Swaziland is marketed by the Swaziland Sugar Association, with sales to the domestic SACU market, preferential markets in the EU and USA, as well as regional markets. Demand for Swazi sugar in the SACU market remained strong and sales ended the season above the levels achieved in 2008/09. Bulk shipments to the EU via Maputo went very smoothly and Swaziland has positioned itself well to take advantage of additional quota opportunities in the EU, prior to 1 October 2009. In addition, regional shortages of sugar resulted in increased sales to these markets at higher returns due to improved world sugar prices.

## 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 - Msolwa and Ruembe - on either side of the Great Ruaha River, strategically linked by a low-level bridge. The estate produces annually around 600 000 tons of sugar cane with outgrowers supplying the balance to support annual production of around 135 000 tons of sugar.

### Agriculture

Rainfall at Kilombero measured less than 50% of the long-term average for the past season. As a result, cane production at Kilombero amounted to 555 000 tons for the year which, due to these very dry conditions throughout the season, was around 10% below that produced in the previous season. An increase in sucrose content helped offset these lower cane yields. There was a similar decrease in cane produced by Kilombero's outgrowers who delivered

a further 526 000 tons of cane for the year. A project to upgrade Kilombero's irrigation and drainage systems is due to commence in 2009/10, designed to improve irrigation and drainage efficiency and cane yields thereafter.

### Sugar production

Sugar production in 2008/09 totalled 118 000 tons, compared to 127 000 tons produced in the previous year. The Msolwa mill operated satisfactorily with marginal improvements in sugar recoveries and operating efficiency, however, reduced cane supplies and a generally disappointing milling performance at the Ruembe mill, impacted negatively upon final sugar production for the season.

Good rains, which have been well distributed across all growing areas, have fallen since the end of January 2009 and weather conditions, including temperatures and sunshine hours, have been conducive to improved growth of the crop. A better cane crop is thus expected in 2009/10 and sugar production is forecast to increase by at least 10%.

### Marketing

There are three sugar producers in Tanzania, with production in 2008/09 amounting to approximately 282 000 tons. This is less than current domestic requirements of around 320 000 tons, with the shortfall provided by duty-paid imports from the world market. Kilombero's share of total industry production was 42% for the past year, all of which was sold domestically. No exports to preferential markets in Europe were made because of higher local prices and good levels of demand. Market conditions during the season were more settled compared to last year due largely to the Government's improved management of controlled imports also impacting positively on illegal smuggling activities. Market prices were also strong.

*Sugar production in 2008/09 totalled 118 000 tons.*

*Cane production of 555 000 tons at Kilombero was negatively impacted by dry weather, with rainfall for the year measuring less than 50% of the long-term average.*





*In Mozambique, the Maragra agricultural operations performed well during the year with increased sucrose content achieved.*

*Consistent operations combined with efficient factory performance resulted in a second year of record sugar production totalling 76 446 tons.*



## MOZAMBIQUE

The Illovo group owns 72% of the equity in Maragra Açúcar Sarl, with the balance held by a private investor. The operation is situated on the eastern coast-line of Mozambique, some 70 kilometres to the north of Maputo. Maragra currently produces around 450 000 tons of cane and just over 76 000 tons of sugar per annum. Outgrowers supply approximately 250 000 tons of cane at present.

A phased expansion of factory capacity has commenced which is designed to increase factory throughput by 40% over two years. Cane supply will increase pursuant to a joint venture between Illovo and the local community to develop 4 000 hectares of new cane land. In addition, local independent growers are planting a further 1 100 hectares adjacent to Maragra. Overall these developments provide the potential to double sugar production at Maragra over the next three years.

### *Agriculture*

The Maragra agricultural operations performed well during the year with increased sucrose content achieved. Efficient cane harvesting and haulage operations continued throughout the crushing season. Drier conditions compared to the previous year impacted marginally upon cane yields, resulting in a slight reduction in cane production to 450 000 tons.

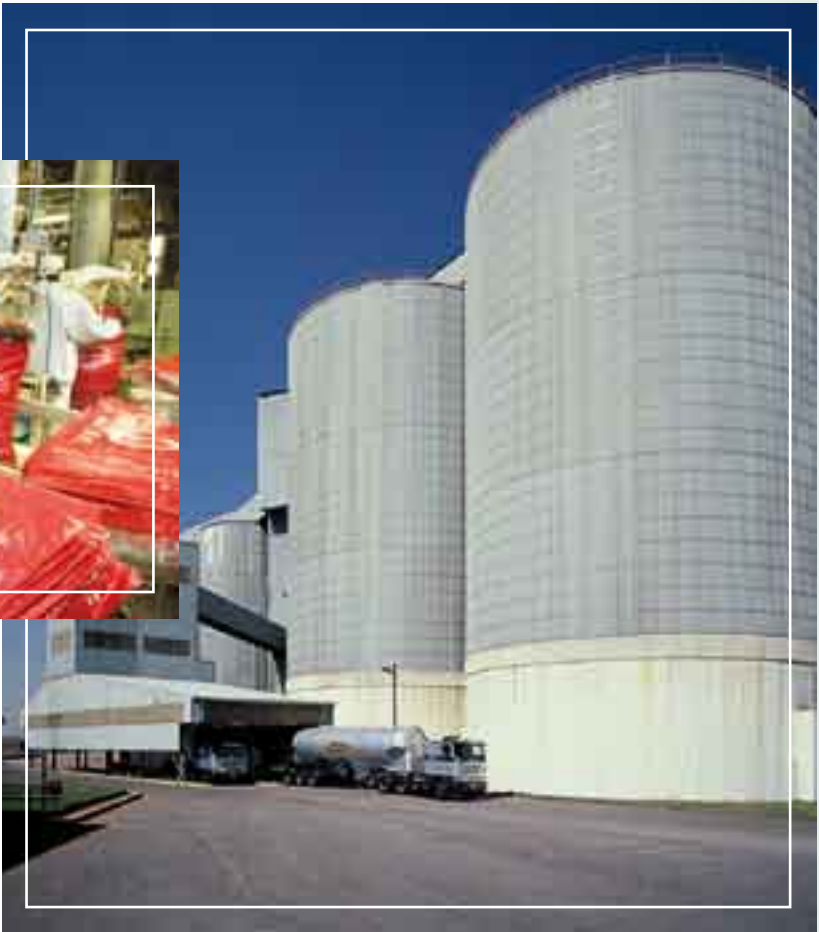
### *Sugar production*

The factory operated consistently throughout the year. Excellent cane quality combined with efficient factory performance, including improved sugar recoveries and an

increase in overall cane throughput, resulted in a second year of record sugar production at Maragra, totalling 76 446 tons. The Maragra expansion project is progressing well and the completion of phase one of the factory capacity expansion has been completed.

### *Marketing*

The domestic market in Mozambique continues to grow and industry sales volumes ended more than 8% above the previous season. Whilst there has been steady growth in the southern region around Maputo, consumer demand surged in the central and northern regions of Mozambique due largely to the absence of illegal sugar imports from Zimbabwe. Cash was also more readily available in these areas following two seasons of good crop production. There was also an increase in demand from the industrial sector which continued to grow due to expansion of the brewing, soft drink and food processing sectors. A successful performance from the industry logistics operation resulted in Mozambique being able to take advantage of EU sugar export opportunities as they arose. The country benefited from EU quota re-allocations, from countries unable to supply and also from an increased LDC quota ahead of duty-free, quota-free access to the EU market from 1 October 2009. The EU market is targeted to receive the major portion of future expanded sugar production in Mozambique. The ports of Nacala, Beira and Maputo are all operating well and are well positioned to handle increased export volumes to the EU.



*During the year, the group's preferential exports from Malawi, Swaziland, Mozambique and Zambia amounted to approximately 211 000 tons.*

*Through dedicated storage and delivery facilities, the group remains the major supplier of sugar to the South African industrial market and increased sales to this sector were achieved during the year under review, particularly to soft drink manufacturers.*

## MARKETS

The group supplies sugar and downstream products to domestic, regional and world markets. Sales to the domestic markets in the countries in which the group operates contributed 69% to total revenue, whilst exports to 88 countries contributed the balance. A significant strength of the group was that 76% of sugar production by volume and 91% by value was sold into domestic or premium-priced export markets.

### Domestic markets

#### Sugar

The SACU market is of major significance for both the South African and Swaziland sugar industries. During the season, total sales into SACU amounted to 1.926 million tons, about 80% being refined sugar and the balance brown sugar. The South African sugar industry supplied 1.427 million tons, Swaziland 320 000 tons and Zimbabwe and other Southern African Development Community (SADC) sugar producing countries 51 000 tons. Duty-paid imports amounted to 132 000 tons of sugar.

In South Africa, approximately 56% of Illovo's total production was sold into the domestic SACU market. Illovo Sugar is Malawi's sole sugar producer and in the 2008/09 season, domestic sales comprised approximately 67% of total sales. About 87% of Zambia's sugar output is produced by Zambia Sugar with domestic sales comprising 61% of total sales. In Swaziland, Ubombo is one of three producers and its production constitutes about 33% of

the country's total output. Swaziland's domestic sales in 2008/09, undertaken by the Swaziland Sugar Association into the SACU market, represented 51% of total sales. Tanzania has three sugar producers but is a net importer of sugar, with annual domestic demand being about 320 000 tons. During 2008/09, all sugar sales in Tanzania were to the domestic market where net returns were higher than those that could have been achieved from the export market. Sugar production in Mozambique, which has four sugar producers, currently amounts to about 250 000 tons, with Maragra's share of industry production being 31%. Around 67% of Maragra's total sugar sales in 2008/09 were sold domestically.

Syrup and speciality sugars are produced in South Africa and Zambia for domestic consumption, whilst speciality sugars made in Malawi and Zambia are produced for preferential markets in the EU and in the case of Malawi also in the US.

#### 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, including Agriguard, a furfural-based agricultural nematicide, as well as lactulose, are traditionally sold in the local South African market.

# Review of operations continued

## Export markets

### Sugar

#### Preferential markets

The group has significant access to high-priced preferential markets in the EU and the USA which are supplied by producers with export entitlements to those destinations. During the year, the group's preferential exports from Malawi, Swaziland, Mozambique and Zambia amounted to approximately 211 000 tons. Malawi and Zambia together supplied around 6 000 tons of sugar into the SACU market in terms of the SADC Sugar Protocol. In Malawi, speciality sugars are produced for markets in the EU and the USA, whilst Zambia also currently produces speciality sugars for the EU market.

#### World markets

More than 100 countries produce sugar, 80% 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, 70% 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 has historically been one of the most volatile of all commodity prices.

The five largest exporters in 2008/09, Brazil, Thailand, Australia, SADC and Guatemala, are expected to supply approximately 85% of all world free market exports. South Africa is currently ranked as the 8th largest exporter to the world market. None of the other countries in which Illovo operates export sugar to the world market.

The world sugar price, although continuing to be very volatile, adjusted upwards during the past year, from an average of US11.84 cents/lb in April 2008 to above US13.00 cents/lb in March 2009. The improvement in this price also resulted in a firming of sugar revenue realisations

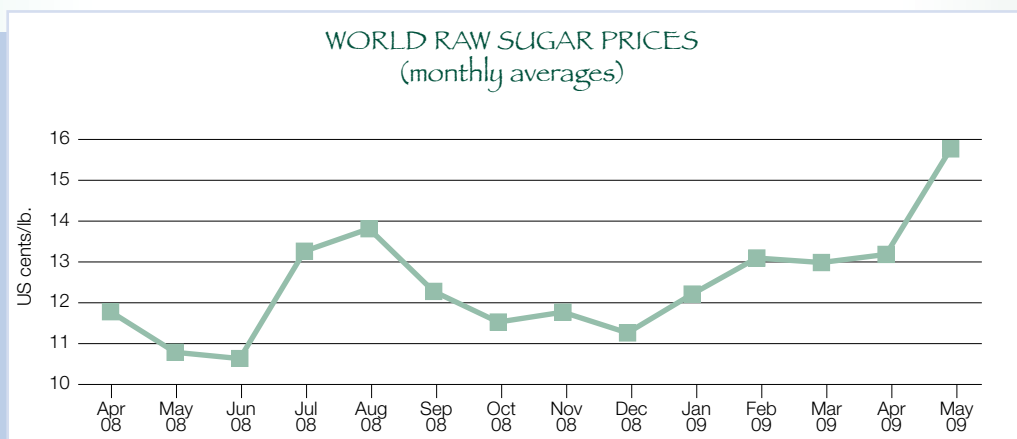
in the regional markets supplied by Illovo. The world price rose in the early part of the year as a result of a forecast deficit in production, but then weakened in line with other commodities. However, in recent months the price has increased strongly, driven by a significant production decline in India, the success of the EU sugar regime reform in reducing output in that region, and capital constraints within the sugar industry in Brazil. These factors have resulted in a material global deficit in production being anticipated, thereby creating a platform for higher sugar prices.

As a major exporter to the world market in 2008/09, the South African Sugar Association (SASA) exported 822 000 tons of raw sugar on behalf of the producers. Exports achieved an average price of US12.77 cents/lb, compared to US10.48 cents/lb in 2007/08, and realised around R2 billion in export proceeds.

Bulk sugar exports to the world market from Illovo's South African operations were above those of last year, representing 44% of production. South Africa, Malawi, Zambia and Swaziland exported sugar during the year to a number of regional markets in Africa, where selling prices are related to the world market price. In all instances, premiums above the world price were achieved as a result of various competitive advantages. Demand was strong and prices benefited from higher average world market prices in 2008/09.

#### 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 and lactulose to 81 countries. In addition, BioMass Sugar, a liquid organic fertiliser derived from sugar cane is being sold to a growing number of international markets. During the year under review, downstream product sales contributed R638.6 million to group revenue.



A material global deficit in sugar production is anticipated in the current 2008/09 international sugar season, creating a platform for higher sugar prices