

# Chairman's statement



*Robbie Williams*

Group operating profit for the year ended 31 March 2010 of R1 499 million reflected an 8% improvement over the previous year, with the operating margin increasing from 16% to 18%.

The results benefited from the positive impact of improved world and regional market sugar prices, increased sugar production in Zambia following the major expansion at Nakambala and good growth in domestic market sugar sales across the group. However, the value of the rand which was significantly stronger compared to the previous year impacted negatively on export revenue in respect of both sugar and downstream products as well as the conversion of foreign subsidiary profits into rands. In addition, adverse weather conditions in Zambia and South Africa reduced anticipated sugar and downstream production, whilst lower prices for sugar exports into the European Union (EU) became effective from 1 October 2009. Net financing costs have reduced to R139 million following the receipt of the rights issue proceeds. The effective rate of tax has normalised at around 30% compared to 20% last year and this has resulted in headline earnings of R703 million showing a decline of 5%. As a result of the dilution impact of the rights issue, headline earnings per share fell in total by 19% to 171.2 cents.

The contributions to operating profit were sugar production 59%, cane growing 34% and downstream 7%. By country, contributions were Malawi 42%, Zambia 18%, South Africa 17%, Tanzania 11%, Swaziland 8% and Mozambique 4%.

Strong cash operating profit of R1 443 million was achieved. The rights issue to raise R3 billion in fresh capital was successfully concluded in September 2009, with a take-up of 99.4%. Consequently, the group has moved from a substantial borrowings position to a net positive cash position of R213 million at year-end, despite expansion projects and the acquisition of businesses amounting to in excess of R1.1 billion being undertaken during the year. The rights issue was progressed to enable the group to pursue major investments outside South Africa in areas which meet its investment criteria. These include positive and stable social, political and economic fundamentals, adequate water and land resources, favourable climatic and agronomic conditions, strong local sugar markets and good export potential.

The agricultural operations generally performed satisfactorily with cane production in the 2009/10 season amounting to 6.1 million tons, an increase of one million tons compared to the previous year. The season was affected by variable weather conditions. South Africa, Tanzania and Mozambique had a very dry winter which was favourable for harvesting the cane crop. South Africa then had a very wet end to the season, which impacted negatively on anticipated cane deliveries, but since then it has been extremely dry. Adverse weather conditions in Zambia, where heavy and unseasonal rainfall severely disrupted cane deliveries, resulted in 3 250 hectares of cane being carried-over to be harvested in the coming year. The performance levels of the factories throughout the group were generally good with improved recoveries of sugar from cane and better operational efficiency levels. The Zambian factory, following the completion of the major expansion, reached rated capacity during the season and achieved reasonable performance.

Group sugar production of 1.685 million tons exceeded the previous season's output by in excess of 100 000 tons, excluding the production of the Umfolozi and Pongola mills which have been sold. The downstream plants operated well. Ethyl alcohol production was similar to last year, but the output of furfural and its derivatives fell by around 10% commensurately with the reduced cane supplies to the Sezela factory.

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Domestic market sugar sales and prices were positive, with all operations achieving similar or improved offtake compared to the previous year. In South Africa, imports continued to have a negative impact on sales volumes, although the quantity has reduced as a result of the higher world sugar prices during the year. However, the South African Customs Union market provided a growth in sales largely due to a reduced presence of Zimbabwe sugar in the region.

The world sugar price was very strong during the year, rising to a 28-year high. The improved world price had a positive knock-on effect for regional prices. The world price increase was driven by a significant production decline in India and capital constraints within the sugar industry in Brazil together with inclement weather during the harvest in that country. The material global deficit in production created the platform for the significant rise in price. However, the price has come under intense pressure since the beginning of February 2010 and is currently more than 50% lower than the high achieved just a few months earlier. Negative macro economic factors generally triggered the decline in the price which was sustained by fund liquidation and speculative selling. Market sentiment is now very fragile, although there is still a global physical supply deficit and prices are now at levels below the cost of production of most major producers. It should be noted that only the South African business is directly exposed to the world sugar market.

The group continues with its drive to significantly increase its cane and sugar production capacity outside of South Africa, and to become self-sufficient in respect of power requirements for its operations as well as supplying power into the national electricity grids in the various countries in which it operates. The first step in the major growth phase was the Zambian expansion project which was completed for the beginning of the 2009/10 season. The expansion resulted in factory capacity increasing to a level which enables sugar production to rise to 450 000 tons per annum. The plant has been settling down and is demonstrating its increased production capability. The Zambian operation also acquired a large cane growing company, Nanga Farms PLC, currently producing 325 000 tons cane per annum with the potential to further increase output. This resulted in the company's own estates now supplying more than 65% of the total cane delivered to the Nakambala factory. The Zambian business completed a rights issue which raised US\$50 million in August 2009, resulting in Illovo's interest in Zambia Sugar Plc reducing from 89.7% to 81.6%, this being supportive of the Government policy to increase local participation in businesses in that country. The proceeds have been utilised to reduce borrowings related to the acquisition of the Nanga operations and the expansion project. The Maragra expansion project in Mozambique, which has increased the factory capacity to around 150 000 tons of sugar per annum was completed for the start of the forthcoming season. Linked to this, the company is currently involved in projects to increase cane supplies from both its own estate and local growers.

The Ubombo factory expansion and co-generation project in Swaziland has commenced. The project provides for an increase in annual sugar production from 220 000 tons to over 300 000 tons, together with an increase in power generation capacity utilising biomass as supplementary fuel for the factory boilers. The power plant will enable the factory and estates to become self-sufficient in electricity consumption. In addition, agreement in principle has been reached with the Swaziland Electricity Company to supply power into the national grid for 48 weeks of the year. The project is linked to the completion of a major new dam and canal system sponsored by the Swaziland Government which will facilitate the development of some 5 000 hectares of new cane land in the medium-term. Development of the first 880 hectares of land is nearing completion and this area will be harvested in 2011. A further 600 hectares is planned for development during the current calendar year.

# Chairman's statement continued

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During the last two years, marginal factory capacity expansions have also been undertaken at Dwangwa and Nchalo in Malawi, and at Kilombero in Tanzania. Additional areas have also been developed to cane by both the company's own estates and outgrowers. New varieties of cane have been introduced and improved irrigation installed in order to improve cane and sucrose yields. Opportunities to further increase the area under cane and improve yields together with related factory expansions are being explored in these countries.

The proposed greenfields project in Mali continues to be progressed, and the various pre-project activities are at an advanced stage. Subject to the Government of Mali meeting certain requirements, the necessary approvals for the funding of the project are likely to be progressed and finalised in the second half of the calendar year. This would facilitate the commencement of cane development, with factory commissioning taking place around two years later.

The sale of the Pongola sugar factory in South Africa to TSB Sugar RSA Limited was approved by the Competition Commission during the year. The disposal was part of a process to consolidate Illovo's business in South Africa. In addition, the capacity of the refinery at Noodsberg is to be increased in the next offcrop and the lactulose plant at Merebank has been expanded. The transfer of the South African business, which remains the largest sugar producer in South Africa, into a wholly-owned subsidiary was completed with effect from 1 April 2010.

Risk management is an integral part of Illovo's business. The safety, security and preservation of our people are essential for the group's sustainable growth. The NOSA Integrated Five Star System covering safety, health and environmental management is implemented at all the cane growing and factory operations. The Disabling Injury Frequency Rate (DIFR) measurement of safety performance is used in all the group's operations, and is included as one of the line-of-sight targets for the performance related bonus scheme. It is pleasing that the DIFR measurements reflect a significant improvement over the past year.

The group operates in diverse environments, many of which are predominantly rural, with limited infrastructure and significant development needs. These challenges are most evident in the countries of operation outside South Africa, four of which are classified by the United Nations as Least Developed Countries. In line with the group's strategic intent as a long-term investor and a major player in these communities, an active social investment programme is in place at each of the operations and is structured to address the specific needs of the respective communities. Illovo qualified for the JSE's 2009 Socially Responsible Investment Index. In addition, it was identified as one of the 30 best performers of the 67 companies qualifying for the 2009 Index, and is one of only 10 companies which has been classified as a best performer for three years running.

The group's investment in health care facilities is significant. 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. Where no other public medical facilities exist, these services are extended to members of surrounding communities. The group operates 24 primary health care clinics and four hospitals. These facilities are staffed by 16 doctors, 150 nurses and other qualified medical staff, and 135 auxiliary personnel, and provide a service to approximately 32 000 employees and 70 000 dependants. In South Africa, the health facilities are clinic-based, and focus on occupational health, primary health care and HIV/AIDS, whilst in the operations in the rest of Africa, the facilities are hospital-based, and focus on primary and secondary health care, occupational health, HIV/AIDS, malaria and other tropical diseases. A pro-active stance is taken against life-threatening epidemics such as HIV/AIDS, malaria and

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tuberculosis. These diseases are being managed, largely on a preventative basis, to negate their impact on the business and the employees themselves.

#### Outlook

In the current 2010/11 year, own cane, sugar and downstream production are all anticipated to exceed the levels achieved in the last season, with output in Zambia expected to increase by more than 25%. World sugar prices are extremely volatile and futures prices are currently below last year's average prices. Although the world sugar market is forecast to remain in deficit, if prices remain at present levels this would be negative for sugar revenues. Domestic market offtake is expected to remain positive. The results for the current year will again be affected by the level of the rand compared to other currencies. In addition, the value of the euro impacts on downstream sales and sugar export earnings from sales to the EU. Sugar exports into the EU are anticipated to grow following increased market access. Whilst this will be of long term benefit to the group, the current financial crisis in the Euro zone and its impact on currency values is likely to have a negative impact on results in the current financial year. Financing costs are expected to be similar to last year. The effective tax rate is expected to remain at around 30%. Overall, the current year is expected to be a difficult one for the company.

#### Directorate

I am pleased to welcome Ami Mpungwe back to the Board as an independent, non-executive director. Mr Mpungwe served on the Board from 2001 to 2006 and was previously the Tanzanian High Commissioner to South Africa. He has a wealth of commercial experience on the African continent. I also welcome Trevor Munday as an independent, non-executive director. Mr Munday has considerable experience in the corporate sector and is a director of other listed companies.

Richard Pike has joined the Board as a non-executive director and replaces David Langlands. Richard joined the British Sugar Group as finance director following the resignation of David from that position. I welcome Richard to our Board and thank David for his contribution during his tenure as a director.

Tony Norton retired at the last annual general meeting in July 2009, and Brian Connellan and Martin Shaw will both retire at the annual general meeting in July 2010. I would like to record our thanks and appreciation to all of them for their valuable contribution and wise counsel over the long period they have been members of the Board. David Haworth will be retiring at the end of May 2010.

#### Appreciation

On behalf of the Board, I would like to thank the people of Illovo for their efforts and contributions during the past year. The group has clear strategies for future growth and the year ahead has many opportunities and challenges for the people of the group.

**R A Williams**  
Chairman

Mount Edgecombe  
28 May 2010