# Review of operations

Graham Clark

## OVERVIEW

The initiative to increase the group's production capacity continues and meaningful progress was made in the period under review. Group cane production increased by more than one million tons to 6.1 million tons and sugar output reached 1.685 million tons compared to 1.578 million tons produced in 2008/09, excluding Umfolozi and Pongola, which have since been sold. These increases were driven primarily from the expansion of the Zambian operations where the existing cane supply was supplemented by nearly 3 000 hectares of newly developed estate cane fields. This, together with additional cane supplied from grower expansions, enabled the factory to produce 120 000 tons more sugar than in the previous season.

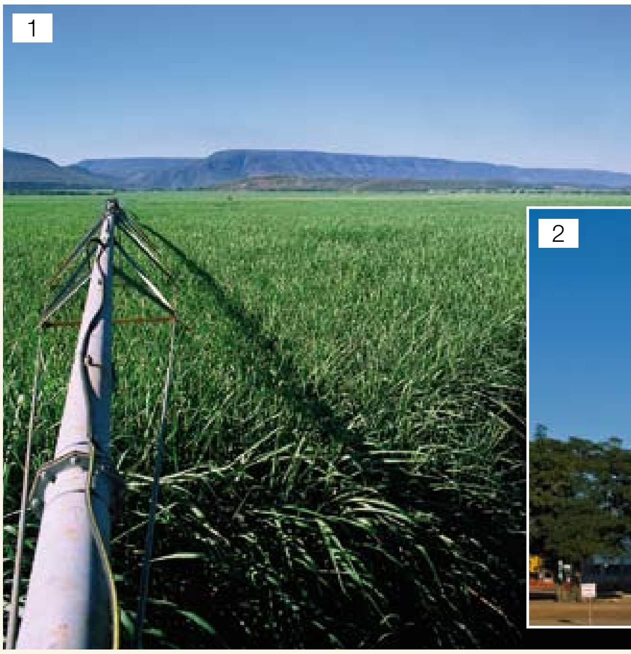
The acquisition of Nanga Farms PLC during the year further consolidated group cane production in Zambia and has strategically resulted in nearly 65% of the total Nakambala cane supply being placed in the hands of the company. The acquisition also provides further future cane expansion potential to the group. Following completion of the major factory expansion in Zambia in April 2009, the plant reached rated capacity during the season and achieved reasonable performance. Growth in the Zambian cane supply and consolidation of factory operations will continue in the coming year and a further 25% increase in sugar production is expected in Zambia in 2010/11.

Increased cane production was also achieved in Malawi, Mozambique, Swaziland and Tanzania following smaller expansions and irrigation upgrades in those countries. In addition, in Tanzania the introduction of new cane varieties has resulted in improved cane yields. The expansion of the Maragra factory in Mozambique has been completed, doubling capacity to 150 000 tons of sugar per annum. Maragra remains actively involved in projects to increase and sustain cane supply from its own estate operations and from surrounding local growers. Marginal capacity expansions have also been completed at the Dwangwa and Nchalo factories in Malawi and at Kilombero in Tanzania.

A further significant group expansion is underway in Swaziland where the Ubombo factory expansion and co-generation project is in progress, due for commissioning at the start of the 2011/12 season. Annual sugar production at Ubombo is to increase by more than 40% to over 300 000 tons per annum. Increased power generation using cane biomass to supplement boiler fuel will enable the Swaziland operation to become self-sufficient in electricity. In addition, following the conclusion of a power purchase agreement with the Swaziland Electricity Company, surplus power will in future be supplied into the national grid for 48 weeks of the year. Increased volumes of cane will be supplied from the agricultural development linked to the completion of a new dam and canal system, promoted by the Swaziland Government. This is expected to result in 5 000 hectares being developed to sugar cane in the medium-term. Approximately 1 500 hectares of this area is expected to be planted to cane by the end of the current year, with the balance over the next two seasons.

The existing operations generally performed well during the past year. Cane yields were good other than in South Africa where adverse weather impacted negatively on the crop and resulted in lower output. Excellent agricultural results continue to be produced in Zambia and Malawi and it was pleasing to note ongoing improvements in cane yields in Mozambique, Swaziland and Tanzania. These result from an ongoing programme of continuous improvement and focus on operational efficiency.

Factory performance was significantly improved compared to the previous year. Mechanical efficiency was better and the sugar recovery from cane was good. Improved throughput was achieved at all factories in the group other than Eston and Sezela in South Africa, where slower crush rates were aligned to lower cane availability. The expanded Noodsberg factory and refinery in South Africa performed better than in the previous year.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*1 Cane production in 2009/10 increased by more than one million tons compared to last year primarily due to the recent expansion of Zambia Sugar's area under cane, together with the acquisition of Nanga Farms.*

*2 Factory performance across the group was significantly improved compared to the previous year. Record sugar production of nearly 81 000 tons was achieved at Maragra which has recently been the subject of a factory expansion project, doubling capacity to 150 000 tons per annum.*



Downstream production at Sezela in South Africa was affected by reduced cane supply in 2009/10. As a result both furfural and furfuryl alcohol production was lower than last year. The production of ethyl alcohol at Merebank increased year-on-year following plant modifications undertaken at the beginning of the season. Increased lactulose production was achieved at Merebank following completion of Stage 1 of a two-phased expansion programme which will be completed next year. The production of diacetyl was also increased in response to higher market demand. Downstream revenue was impacted by lower export prices compared to the record high levels experienced in the previous year. Furfural and furfuryl alcohol prices in particular were negatively affected by the global economic downturn, and the strength of the rand further depressed downstream earnings. However, alcohol sales benefited from strong local demand at good prices.

Performance in the various sugar markets supplied by the group during 2009/10 was strong. Illovo's domestic markets continue to be a primary focus and all were the subject of strong demand. In South Africa, Illovo continues to be the major supplier to the industrial market, whilst a more focused approach to the retail market proved beneficial. In South Africa, imports continued to have a negative impact on local sales volumes although imported sugar tonnages were lower year-on-year as a result of higher world sugar prices. In Malawi, local sugar demand remained strong and growth was only constrained by production. Domestic markets in Mozambique, Swaziland, Tanzania and Zambia all performed strongly with Tanzania enjoying firmer prices as sugar was imported at high world prices to supply local production deficits.

Reform of the current European Sugar Regime was completed during the year with the previous system of quota access coming to an end on 30 September 2009. Advantage was taken of available quota prior to 30 September 2009 and the transition to quota free, duty free access for qualifying origins went well thereafter. The final reduction in the European raw sugar price became effective from 1 October 2009 and will impact on export revenue from the European Union (EU) going forward. Contracts have been negotiated to supply European refineries via Mitra Sugar, the marketing joint venture between Illovo and British Sugar. Land and marine logistics continue to be consolidated as tonnages being routed to the EU increase.

The world sugar price, which directly affects only South African exports, rose strongly during the year, peaking at a 28-year high of US30 cents/lb in February 2010. The increase was driven by production declines in India and Brazil, the world's two largest producers, leading to a growing global sugar deficit. Year-on-year, the average world sugar price achieved by the South African Sugar Association (SASA) increased by 29% from an average of US12.77 cents/lb in 2008/09 to an average of US16.53 cents/lb in 2009/10. This benefit was however largely undermined by the very strong rand. The world sugar price has fallen dramatically since February/March 2010, losing half of its value and leaving the market very fragile. Resistance appears to have been established between US14 and 15 cents/lb and although still volatile, this range places the world price structurally below the cost of production for many of the world's largest sugar producers, notably in Brazil.

Regional export prices rose on the back of higher world prices and benefited further from lower availability from Zimbabwe. Good advantage was taken of these opportunities by Malawi, Swaziland and Zambia.

The global economic downturn resulted in a number of base commodity prices decreasing during the year compared to the rapid escalation experienced in 2008/09. The opportunity to procure major inputs such as fertiliser, coal, packaging and steel at lower base prices assisted in containing costs of production. Strong local currency exchange rates also restrained further cost escalation. The group remains focused on lowering costs of production where possible and it was encouraging that the group's operating margin increased from 16% to 18% for the year, despite a fall in revenue. A formal benchmarking and cost optimisation process has been introduced within the group to assist in lowering the costs of production.

*The production of ethyl alcohol at Merebank increased year-on-year following plant modifications undertaken at the beginning of the previous season.*

## STRATEGIC REVIEW

The group goals and objectives continue unchanged, with primary objectives being to remain a world class, low-cost and highly efficient organisation seeking to enhance shareholder wealth and optimise growth, whilst at the same time achieving a sustainable, balanced and integrated economic, social and environmental performance.

High standards of corporate governance are demanded from all group operations and compliance is regularly reviewed. 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. Annual strategic plans and budgets are prepared with these aspects in mind.

### Growth philosophy

The group continues to consolidate its South African operations in order to maintain a profitable, stand-alone South African entity with the capacity to maintain acceptable group returns. In the rest of Africa, where there is potential for superior returns, investments 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 up-date

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

#### South Africa

- The rationalisation of the South African business has progressed, with finalisation during the year of the sale of the Pongola sugar mill to TSB Sugar RSA Limited. This followed the sale in the previous year of the Umfolozi mill and the acquisition of a 30% shareholding in the Gledhow sugar mill and refinery. The South African operations now comprise three agricultural estates, four sugar factories, one incorporating a refinery, five downstream plants and the 30% share in the Gledhow mill and refinery where management and technical support is also provided by Illovo.
- The South African business, comprising the above operations, has been incorporated into a wholly-owned subsidiary – Illovo Sugar (South Africa) Limited, which began operating on 1 April 2010.

#### Mozambique

- A two-phased project to double factory capacity at Maragra to 150 000 tons of sugar per annum was completed on schedule in April 2010.
- Maragra remains actively involved in projects to increase and maintain cane supply from its own estate operations and from surrounding local growers.
- Longer-term opportunities to increase total sugar production in Mozambique to at least 300 000 tons continue to be evaluated. The company has chosen not to exercise its option to participate in the Búzi project and instead is looking to leverage from the operational and management base at Maragra by investigating alternative expansion areas.

*Illovo's domestic markets continue to be a primary focus and all were the subject of strong demand in 2009/10.*


### Zambia

- The expansion of the Nakambala operation was completed in April 2009 and has been fully commissioned, becoming operational during 2009/10. This provides the base to produce up to 450 000 tons of sugar annually in Zambia.
- The acquisition of Nanga Farms PLC, adjacent to the Nakambala estate was completed during the year. In addition to increasing the extent of the company's cane operations, the acquisition has resulted in the company's own estates now supplying 65% of the total cane delivered to the Nakambala factory.

### Swaziland

- The first phase of the expansion of the Ubombo factory was completed on schedule in time for the start of the 2010/11 season. The second phase of the project, which incorporates the power co-generation component of the project is well advanced, set for commissioning in April 2011.
- Factory capacity will increase from 220 000 tons to in excess of 300 000 tons of sugar per annum.
- Following completion of a major dam and canal system, promoted by the Swaziland Government, development has commenced on the first 1 500 hectares of cane development as part of the initial development area of 5 000 hectares.

### Malawi

- Marginal factory capacity expansions have been completed at both factories in Malawi over the past two seasons. Combined, the two Malawian factories now have the capacity to produce approximately 330 000 tons of sugar per annum.
- New areas of cane have been planted on both estates and in addition, support for small-scale growers will result in an increase in outgrower cane in the next two years.
- Options for further significant expansion in Malawi are being evaluated. Considerable potential exists for further development of the estate and outgrower cane operations in Malawi. Opportunities for power co-generation are also being assessed.

### Mali

- The proposed greenfields project in Mali continues to be progressed and pre-project activity is at an advanced stage. Funding for the project is currently being evaluated and subjected to final due diligence from a consortium of concessional funders. Support from the Government of Mali is strong and necessary formalities for the debt funding of the project are likely to be concluded in the second half of 2010. This would facilitate the phased commencement of cane development, with factory commissioning requiring about two years thereafter to complete.
- The Malian operation will ultimately produce 195 000 tons of sugar, 15 000 kilolitres of ethanol for fuel blending and generate sufficient electricity for the agricultural factory and operations, with additional capacity to export power into the national grid.

*Karin Zarnack*

**SEGMENTAL ANALYSIS**

*2010*

**Country key**

- South Africa
- Malawi
- Zambia
- Swaziland
- Tanzania
- Mozambique

**Activity key**

- Sugar
- Cane growing
- Downstream

*2009*

## FINANCIAL REVIEW

### Group performance

Group revenue decreased by 2% from R8 602 million to R8 468 million in the current year mainly due to the disposal of the Pongola and Umfolozi mills, at the beginning of the year. Operating profit has however, improved by 8% to R1 499 million. A focused cost reduction programmme, increased sugar production in Zambia, continued growth in domestic market sales as well as higher world and regional sugar prices have contributed to the improvement in profits. However, the stronger rand against all currencies has negatively impacted export revenues together with the conversion of foreign subsidiary profits into rands. At a constant conversion exchange rate ignoring the impact of rand strength, revenue and operating profit would have increased year on year by 9% and 23% respectively. Operating margins were higher at 18% (2009: 16%).

Net financing costs of R139 million were lower than last year's R185 million. Included in net financing costs in the current year is a foreign exchange gain of R124 million mainly related to a US dollar-denominated loan to Zambia Sugar. In September 2009, the company completed a R3 billion rights issue and the benefits of the additional cash has contributed to the reduction in net financing costs. Interest of R14 million (2009: R258 million) was capitalised to expansion projects in the current year.

Included in material items is the net loss on the sale of the Pongola mill, together with the impairment of an investment in an agricultural joint venture in Mozambique. Both these items, together with the profit on the sale of property, plant and equipment have been added back for headline earnings purposes.

The tax charge of R412 million included current tax of R273 million, deferred tax of R102 million and secondary tax on companies of R37 million, resulting in a normalised effective tax rate of 30% for the year (2009: 20%). This is higher than last year's effective tax rate due to expansion-related tax allowances granted to the Zambian operations being fully utilised on the completion of the expansion.

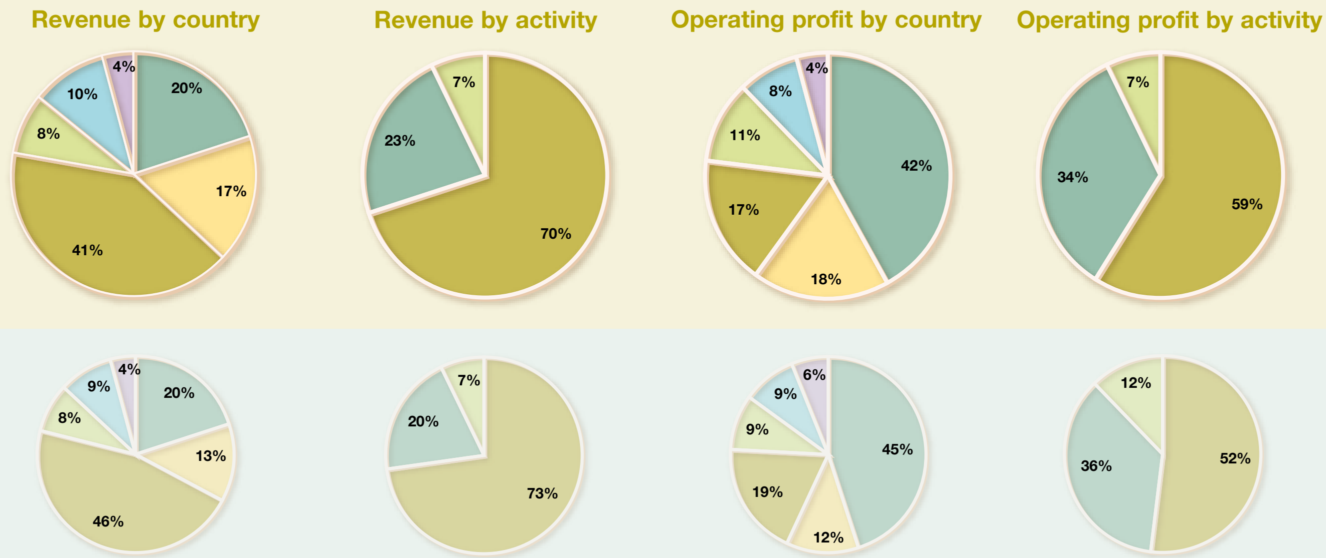
### Earnings and distributions

Headline earnings have declined by 5% to R703 million (2009: R742 million). The weighted average number of shares in issue has however increased by 59.8 million shares to 410.3 million due to the rights issue. The reduced profits after taxation and the dilutive effect of the rights issue shares, has resulted in headline earnings per share decreasing by 19% from 211.6 cents to 171.2 cents.

An interim dividend of 32.0 cents was paid and a final capital distribution in lieu of dividend of 54.0 cents has been proposed. The strength of the balance sheet and results achieved have made it possible to maintain a dividend twice covered by earnings. In accordance with International Financial Reporting Standards, no liability has been raised for this final distribution. The source of the distribution will be a capital reduction out of share premium and therefore the cost of the proposed distribution of R249 million has been transferred from share premium to a separate distribution reserve.

### Statement of financial position

Non-current assets increased by R327 million to R5 751 million. Property, plant and equipment of R4 263 million increased by R237 million mainly driven by expansion capital, in particular the factory




expansions in Zambia and Mozambique, of R846 million, the acquisition of Nanga Farms PLC of R167 million and replacement capital expenditure of R181 million. Assets of R183 million were disposed of during the year and depreciation was R250 million. The impact of the stronger closing rand exchange rate reduced the closing value of property, plant and equipment on conversion by R524 million.

The Zambian business completed a rights issue which raised US$50 million in August 2009, and resulted in Illovo's interest in Zambia Sugar reducing from 89.7% to 81.6%. The proceeds have been utilised to reduce borrowings related to the acquisition of Nanga Farms as well as expansion related debt. On the consolidation of Nanga Farms, an intangible asset of R106 million was raised which represents the strategic value of the cane supply that was secured by this transaction.

The R3 billion rights issue proceeds were utilised to settle the ABF inter-company loan of US$120 million as well as various external rand and dollar loans. The remaining cash on hand at year-end of R1 345 million together with group facilities will be utilised to invest in future expansion projects.

Return on average shareholders' equity was 15% (2009: 29%). This decline is largely as a consequence of the level of investment made this year in long-term capital projects which have yet to yield a return.
A currency loss of R618 million arose on the translation of the group's foreign currency denominated net assets into rands. This resulted from the fact that the rand was stronger against all major currencies at the end of this year than at the end of the previous year. The group's net asset value increased by R2 870 million to R6 315 million.

## Capital expenditure and future capital commitments

A summary of the group's 2010 capital expenditure and future capital commitments is set out below –

| Rm | Capital expenditure | | Capital commitments | | | Total capital commitments |
|---|---|---|---|---|---|---|
| | 2010 | | 2011 | | + 2012 | |
| | Expansion | Ongoing | Expansion | Ongoing | Expansion | |
| South Africa | 179 | 54 | 93 | 96 | 12 | 201 |
| Malawi | 64 | 40 | 14 | 50 | – | 64 |
| Zambia | 234 | 20 | – | 38 | – | 38 |
| Swaziland | 172 | 22 | 1 325 | 63 | 63 | 1 451 |
| Tanzania | 17 | 17 | 60 | 20 | – | 80 |
| Mozambique | 180 | 28 | 55 | 42 | – | 97 |
| Mali | – | – | – | – | 1 440 | 1 440 |
| Group | – | – | – | 44 | – | 44 |
| Total | 846 | 181 | 1 547 | 353 | 1 515 | 3 415 |

With the exception of the projects in Mali and Swaziland which will be project financed, the group has sufficient cash reserves, cash generated from operations and committed bank financing facilities to fund this approved capital expenditure.

With the recent changes in the financial markets together with an increase in the average cost of debt, target hurdles rates for potential new projects have been determined as follows –

| | |
|---|---|
| Internal rate of return | above 20% |
| EBIT/capital at steady state | above 20% |
| Payback | less than 7 years |

These hurdles ensure that capital is applied to projects that give the best returns on investment. Management also continues to monitor the performance of entities and will also consider injecting equity in order to maximise shareholders' returns.

### Cash flow

The group continued to achieve strong cash operating profit of R1 443 million, compared to R1 207 million last year. The group continued to invest in the future growth of the group with R1 352 million spent on factory and agricultural expansion projects, replacing existing property, plant and equipment, research including product registrations and acquisitions, principally Nanga Farms. R119 million was received for the disposal of businesses. Other cash outflows included taxation of R304 million, dividends of R490 million and net financing costs of R139 million. This resulted in a cash outflow before financing activities of R985 million. This cash outflow together with the repayment of debt of R1 427 million, was funded by the Illovo and Zambia Sugar rights issues proceeds of R3 213 million, resulting in an increase in cash of R801 million.

### Financing

At the year-end, the group had total committed bank facilities amounting to R2 194 million of which R1 014 million was drawn-down. R1 225 million of these facilities are short-term in nature with the remainder maturing between 2012 and 2015. The group also had access at year-end to uncommitted facilities of R1 618 million of which R118 million was drawn-down. Cash on hand at year-end totalled R1 345 million, resulting in a net cash position of R213 million.

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. The committee operates within group policies approved by the board and is responsible for arranging term debt facilities for expansions and acquisitions as well as short-term working capital facilities. 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 for the group over the medium-term after expansion.

### 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 contracts. Exchange rate exposures are managed within approved policy parameters utilising forward exchange rates. The group is also exposed to fluctuations of the rand against the currencies of the countries in which it operates, in particular on the conversion of local profits into rands. These profits are converted at the actual average exchange rate for the year and cannot be hedged.

### Accounting policies

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

The accounting policies are consistent with those applied in the prior year, except for the revised IAS 1 Presentation of Financial Statements and IFRS 8 Operating Segments which were adopted during the current year. The adoption of these new and revised standards has resulted in certain disclosure reclassifications and therefore had no impact on the group's accounting policies.

### Subsequent events

No material changes have taken place in the affairs of the group subsequent to year-end.

*1 Cane production in South Africa in 2009/10 amounted to 361 000 tons which, together with deliveries from private growers, resulted in the production of 663 000 tons of sugar.*

*2 The raw sugar mills enjoyed successful seasons with good recoveries of sugar from cane and high levels of mechanical and operational efficiencies achieved at Eston, Sezela and Umzimkulu.*





**OPERATIONS**

## South Africa

Illovo remains South Africa's largest sugar producer, with its operations strategically located across the eastern and southern section of KwaZulu-Natal. The operations consist of three agricultural estates, four sugar factories, one of which incorporates a refinery, and five downstream plants, three of which are wholly-owned and two are 50% owned with joint venture partners. Approximately 670 000 tons of sugar are produced annually from around 5.6 million tons of cane, 360 000 tons of which is supplied by the company's own agricultural operations and the balance by private growers. Furfural, furfuryl alcohol, Agriguard, diacetyl, 2.3-pentanedione, ethyl alcohol and lactulose are produced at the various downstream plants. In addition, the group has a 30% investment in the Gledhow sugar factory and refinery which it manages and to which it provides technical support. The South African operations currently employ approximately 2 100 permanent employees and 2 000 seasonal workers at peak periods, and in 2009/10 contributed 17% of total group operating profit.

### *Agriculture*

Cane production in 2009/10 amounted to 361 000 tons. Cane yields and sucrose content at Umzimkulu benefited from above average rainfall in the growing months of January and February 2009. Extensive hail damage early in the growing season at Eston impacted negatively on both cane yields and sucrose content which were both well below those experienced in the previous season. Above average rainfall for the month of December made cane harvesting at the closure of the season difficult, resulting in cane being carried over to the current season at Sezela and Umzimkulu.

Cane deliveries from small-scale growers, excluding Pongola and Umfolozi, amounted to 244 000 tons representing 4% of total deliveries to Illovo's mills, whilst cane supplied by medium-scale growers decreased marginally to 357 000 tons compared to the previous season. 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.

Currently, 43% of the total land area supplying cane to Illovo mills is the subject of land claims in terms of the Restitution of Land Rights Act, 1994. Thus far, of the areas claimed, just over 10% 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. Land reform committees are very active in all mill areas and Illovo is playing a leading role in sugar industry land reform initiatives.

### *Sugar production*

The raw sugar mills enjoyed successful seasons with good recoveries of sugar from cane and high levels of mechanical and operational efficiencies achieved at Eston, Sezela and Umzimkulu. The factory and refinery

1 *Record lactulose production was again achieved at Merebank, with the plant having benefited from a further expansion of its capacity during the season.*

2 *Illovo's domestic market sales performance was pleasing, particularly in the brown sugar sector.*

performance at Noodsberg showed considerable improvement, with the refinery in particular operating consistently well and producing record refined sugar production. Energy conservation initiatives at Noodsberg and Sezela proved highly successful and realised significant coal savings. Total sugar production amounted to 663 000 tons, with the corresponding share of industry production decreasing from 41% in 2008/09 to 30% in 2009/10 following the sales of the Umfolozi and Pongola mills.

The Gledhow sugar factory and refinery performed well, producing 132 000 tons of sugar.

### *Downstream*

The furfural plant at Sezela operated consistently throughout the year although production was affected by irregular cane supplies in the latter part of the season resulting in a slight decrease in production compared to last year. Both the Merebank and Glendale distilleries continued to perform well, and maintained consistent quality and good throughput levels throughout the year. Record lactulose production was again achieved at Merebank, with the plant having benefited from a further expansion of its capacity 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. Despite reduced refined sugar availability arising out of the sale of the Pongola factory and refinery, Illovo's domestic market sugar sales performance was pleasing, particularly in the brown sugar sector. The group remains the major supplier of sugar to the South African industrial market. Regional market sales into the South African Customs Union (SACU), which has traditionally been supplied from Zimbabwe, were again boosted this year due to that country's current sugar production difficulties.

Illovo's share of raw sugar exports to the world market, undertaken by the SASA, amounted to 233 000 tons for the year. The average price realised by the industry, including hedging activities undertaken by SASA, was US16.53 cents/lb, representing an increase of US3.76 cents/lb compared to the previous year, due to the higher average world market price experienced during 2009/10. In respect of the 2010/11 season, around 230 000 tons of sugar, representing approximately 30% of world market export availability, have been priced to date on behalf of the industry by SASA, at an increased average price of US20.66 cents/lb. Futures prices are currently around US15 cents/lb.

The downstream operations had a challenging year, following a very successful performance in the previous season when international furfural prices were at record highs. Initially, furfural and furfuryl alcohol prices decreased significantly in line with the world economic downturn, although in recent months these prices have recovered as an exceptionally severe winter in China resulted in the temporary closure of almost all furfural plants in that country. Export alcohol prices were strong, whilst the lactulose business capitalised on record production.

The Agriguard business continued to expand gradually as further regulatory access was gained during the season and growing sales into new markets and for new crops commenced. In South Africa, Crop Guard achieved registration for use on vines and stone fruit, and a refocused marketing initiative resulting in sales volumes more than doubling.

MultiGuard Protect remained under review at the United States Environmental Protection Agency in respect of its use on turf. BioMass Sugar, a liquid organic fertiliser derived from sugar cane, showed good international growth during the year with expansion and sales into new geographic locations.

*1 Total cane production of 2.1 million tons from the agricultural operations at Dwangwa and Nchalo was marginally above that produced last year.*

*2 Combined sugar production in 2009/10 amounted to 295 000 tons, marginally below last year's record output of 304 000 tons.*

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Nchalo mill

## Malawi

Illovo Sugar (Malawi) Limited is listed on the Malawi Stock Exchange with the Illovo group holding 76% of the issued share capital and the balance being held by institutional investors and the public. The company is Malawi's only sugar producer with significant agricultural, milling and refining assets at the Dwangwa sugar estate situated in the mid-central region and at the Nchalo sugar estate in the south of the country. In a normal season, combined with supplies of cane from Malawian small-holder growers, around 2.5 million tons of cane can be produced in Malawi enabling the production of approximately 330 000 tons of sugar. The Malawi operations currently employ approximately 5 300 permanent employees and more than 8 000 seasonal workers at peak periods, and in 2009/10 contributed 42% of total group operating profit.

### *Agriculture*

Cane growing operations at both estates benefit from access to secure water sources for irrigation, resulting in excellent yields and high sucrose content in cane. Cane grown at Dwangwa is irrigated from the Rupashe River, supplemented by water from Lake Malawi, whilst Nchalo sources water from the Shire River.

Total cane production of 2.1 million tons from the agricultural operations at Dwangwa and Nchalo was marginally above that produced last year, although impacted by unfavourable weather conditions during the season. Outgrowers were similarly affected, bringing combined cane production for the season to 2.36 million tons. An expansion programme, to increase land under irrigated cane by 1 300 hectares, was completed and is expected to further enhance cane production in the forthcoming season.

### *Sugar production*

Combined sugar production in 2009/10 amounted to 295 000 tons, representing a 3% decline compared to last year's record production of 304 000 tons. Lower than forecast sucrose content in cane, particularly at Nchalo, impacted negatively on final sugar output. Operating efficiencies at the factories were generally satisfactory, however both were at times negatively affected by mechanical performance. An enhanced focus on plant maintenance and operations management during the current offcrop maintenance period has addressed the problems encountered.

Both factory operations produce molasses as a by-product of the sugar manufacturing process, which is currently sold as fermentation raw material to the Ethanol Company Limited and Presscane Limited, both fuel alcohol distilleries in Malawi.

### *Marketing*

Approximately 66% of sugar produced by Illovo Malawi is currently sold to local industrial and consumer markets, whilst 21% is exported to markets in the EU and US. The remainder is sold into regional and other selected markets.

Domestic sugar sales volumes for the year were constrained by the reduced sugar production and amounted to 194 000 tons. Regional sales, particularly into Zimbabwe, were supported by strong demand and good prices. The balance was sold into the EU market in respect of which, effective from 1 October 2009, Malawi now is entitled to full duty-free, quota-free access, albeit at the reduced EU price.

1 In Zambia, the agricultural operations incorporating Nanga Farms produced a record cane crop of 1.7 million tons in 2009/10, compared with 720 000 tons in the previous year.

2 In its first year of operation following the expansion of the Nakambala factory, record sugar production of 315 000 tons was achieved.



## Zambia

Zambia Sugar Plc, which is listed on the Lusaka Stock Exchange, is the country's leading sugar producer, with a 94% share of industry production. In August 2009, the company completed a successful rights issue which raised US$50 million. During the process, the Illovo group partially renounced its rights and consequently reduced its shareholding in Zambia Sugar from 89.7% to 81.6%, thereby enabling increased public ownership in the company. This reduction is supportive of government policy to increase local participation in business. The proceeds were used to reduce borrowings related to the recent major expansion project and the acquisition of Nanga Farms. Zambia Sugar is based at Nakambala, adjacent to Mazabuka in the south of the country. It is the single largest private agricultural and milling company, and employer in the region. The Zambian operations currently employ slightly less than 2 000 permanent employees and just over 4 000 seasonal workers at peak periods, and in 2009/10 contributed 18% of total group operating profit.

In December 2009, Zambia Sugar's recent major expansion project was officially commissioned by President Jacob Zuma of the Republic of South Africa and President Rupiah Banda of the Republic of Zambia. The R1.7 billion project, which resulted in the development of an additional 10 500 hectares of irrigated cane fields by the company and its supplying growers, along with the expansion of the factory's milling capacity, will enable the increase in annual sugar production from around 200 000 tons to 450 000 tons. The acquisition of the neighbouring Nanga Farms has further increased annual company cane production by around 325 000 tons.

### *Agriculture*

The agricultural operations incorporating Nanga Farms produced a record cane crop of 1.7 million tons in 2009/10, compared with 720 000 produced in the previous season. Heavy and unseasonal rainfall during the season, however, impacted negatively upon cane deliveries, resulting in an area of 3 250 hectares of cane land being carried-over for processing in 2010/11. Outgrower deliveries amounted to approximately 910 000 tons of cane, bringing total cane production to 2.6 million tons.

### *Sugar production*

In its first year of operation following the expansion of the factory, record sugar production of 315 000 tons was achieved, representing a 62% increase in tonnage compared to the previous season. Overall, factory performance and efficiencies showed considerable improvement over the previous season, with the plant reaching its new rated capacity.

### *Marketing*

Continued improvement in the company's domestic distribution and depot system, together with the promotion of specific pack sizes, resulted in record local sales of 130 000 tons of sugar representing a 10% increase compared to last year. The prevailing strong macro-economic fundamentals and stable domestic currency assisted in curtailing illegal sugar importation activities.

With increased sugar availability, exports into the region increased from 35 000 tons in 2008/09 to 87 000 tons during the year under review. Zambia Sugar exported a record 90 000 tons of sugar to the EU in respect of which, effective from 1 October 2009, Zambia is entitled to full duty-free, quota-free access, albeit at the reduced EU price.

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*1 Phase two of the Ubombo factory expansion and co-generation project in Swaziland will be completed before the commencement of the 2011/12 season. The required additional cane throughput will be sourced primarily via the Lower Usuthu Smallholder Irrigation Project involving the development of land to irrigated cane by local Swazi growers, supported by the government.*

*2 The second phase of a four-year project to convert a portion of Ubombo's irrigated fields to centre pivot irrigation was completed in 2009/10.*

## 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 800 000 tons of cane and 220 000 tons of sugar. The Swaziland operations currently employ approximately 1 300 permanent employees and more than 1 500 seasonal workers at peak periods, and in 2009/10 contributed 8% of total group operating profit.

Phase one of a major R1.5 billion factory expansion and co-generation project at Ubombo has been completed, with phase two scheduled for completion before the commencement of the 2011/12 season. The project, which is the single largest commercial investment in Swaziland in recent years, will increase annual factory milling capacity by more than 40% to in excess of 300 000 tons of sugar and significantly raise power generation capacity, utilising biomass from cane as supplementary fuel for the factory boilers. The project is linked to the government-sponsored Lower Usuthu Smallholder Irrigation Project (LUSIP) under which a major new dam and canal system has been constructed, and which will facilitate the new development of an initial 5 000 hectares of land to cane under irrigation in the medium-term. Development of the first phase is underway, with planting expected to be completed during the year for harvest in 2011. Subsequent phases of cane development will continue to be undertaken using government and EU funds between 2011 and 2012. The co-generation project will enable the factory and agricultural operations to become self-sufficient in electricity consumption and will export surplus power into the national grid. In this regard, agreement in principle has been reached with the Swaziland Electricity Company for the supply of this electricity into the national grid.

Ubombo is well advanced towards registration for carbon credits under the Clean Development Mechanism, derived from the replacement of fossil fuels and renewable energy production.

### *Agriculture*

Cane production at Ubombo in 2009/10 amounted to just over 800 000 tons, representing a 9% increase compared to the previous season. There was an encouraging increase in cane yields, benefiting from ongoing modernisation of and upgrading of irrigation systems. Cane quality was negatively affected by higher than normal rainfall received in the latter part of the year, which resulted in the delayed closure to the harvesting season.

The second phase of a four-year project to convert a portion of Ubombo's irrigated fields to centre pivot irrigation was completed in 2009/10. The primary aim of the upgrade is to improve water usage efficiencies and increase cane yields.

### *Sugar production*

The 2009/10 harvesting season was extended following rain-related disruptions to cane supply. Lower cane quality towards the end of the season due to the rains affected factory efficiencies which resulted in sugar production of just over 211 000 tons being marginally higher than production in the previous season. Factory performance was generally satisfactory with various factory records being established. The Ubombo refinery ran well throughout the year. Ubombo experienced further positive benefits of its biomass initiative, which utilises residual cane tops and leaves combined with bagasse to fuel the factory boilers, with the ultimate objective of eliminating coal usage.

1 Despite very dry conditions, Kilombero's agricultural operations benefited from improved irrigation efficiencies, the introduction of new, higher-yielding cane varieties and longer sunshine hours during the season.

2 Sugar production in Tanzania amounted to just over 120 000 tons.

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*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 US, as well as regional markets. Demand for Swaziland sugar in the SACU market remained strong and sales ended the season marginally above the levels achieved in 2008/09. Bulk shipments to the EU via Maputo went smoothly and Swaziland positioned itself to take advantage of additional quota opportunities in the EU prior to the 25% price decline which came into effect on 1 October 2009. Since then, Swaziland has become entitled to duty-free and quota-free access to the EU, subject only to a global safeguard applied to all African, Caribbean and Pacific (ACP) countries. In addition, regional shortages of sugar in east and central Africa resulted in increased sales to these markets at higher premiums, in line with 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, linked by a low-level bridge. The estate produces annually in excess of 600 000 tons of cane, with outgrowers supplying a further 500 000 tons in a normal year. The combined annual sugar production capacity of both factories is currently approximately 135 000 tons. The Tanzanian operations currently employ approximately 700 permanent employees and more than 4 500 seasonal workers at peak periods, and in 2009/10 contributed 11% of total group operating profit.

*Agriculture*

Despite very dry conditions, Kilombero's agricultural operations benefited from improved irrigation efficiencies, the introduction of new, higher-yielding cane varieties and longer sunshine hours during the season. Cane production amounted to 614 000 tons, representing an 11% increase over the previous season. However, outgrower cane production, which is rain-fed, was negatively impacted by the dry conditions and decreased by around 11% to 476 000 tons.

New irrigation systems covering about 450 hectares of land were installed during the past season, including a linear/lateral irrigator, particularly suitable for large tracts of flat agricultural land. In addition, a project to improve the drainage network in order to reduce infield water retention during periods of high rainfall, commenced during the season. In 2010/11, a further 1 060 hectares of existing cane land will be converted to upgraded irrigation and drainage systems. In a separate initiative to assist Kilombero's outgrowers, funding is being sought from the EU's Accompanying Measures programme in order to investigate the feasibility of irrigating some of their cane lands.

*Sugar production*

Sugar production in 2009/10 amounted to just over 120 000 tons, a marginal increase over the previous year. The Msolwa factory operated satisfactorily with improved extraction and increased efficiency, whilst there was a slight improvement in sugar recovery from cane at Ruembe. However, the performance of both factories was negatively impacted by wet conditions at the end of the year and in January 2010.

*1 In Mozambique, a two-phased project to double factory capacity to 150 000 tons of sugar per annum at Maragra was commissioned as planned at the commencement of the 2010/11 season.*

*2 Stable weather conditions during the season at Maragra resulted in increased efficiencies in harvesting and haulage operations.*

*3 The factory operated consistently throughout the year resulting in a third consecutive year of record sugar production.*

### *Marketing*

There are three sugar producers in Tanzania. Aggregate domestic production from all three producers declined from previous levels to just under 270 000 tons in 2009/10, primarily due to difficult weather conditions. Current domestic requirements of sugar amount to around 400 000 tons, with the balance provided by duty-paid imports from the world market. Kilombero's share of total industry production was 46% in the past year, all of which was sold domestically. No exports to preferential markets in the EU were made as domestic market conditions and prices remained strong throughout the season, resulting from lower domestic production and higher import prices.

## Mozambique

The Illovo group is the majority shareholder in Maragra Açucar SA, with the balance of shares held by a private investor. During the year, Illovo increased its holding in Maragra from 71.5% to 74.0%. In the same transaction, Maragra also acquired approximately 300 hectares of new cane land. The operation is situated on the coast-line of Mozambique, about 80 kilometres north of Maputo. In the 2009/10 season, sugar production amounted to a record of nearly 81 000 tons with approximately 490 000 tons of cane produced by the agricultural operations and 140 000 tons of cane supplied by local outgrowers. The Mozambique operations currently employ just less than 1 000 permanent employees and around 3 000 seasonal workers at peak periods, and in 2009/10 contributed 4% of total group operating profit.

In total, the sugar industry in Mozambique produced 253 000 tons of sugar during the season under review, representing a slight increase over that produced in 2008/09. Maragra increased its share of production from 30.5% in 2009, to just over 32% in 2009/10.

A two-phased project to double factory capacity to 150 000 tons of sugar per annum, was commissioned as planned and within budget at the commencement of the new season. The expansion will take advantage of both company and private grower cane development initiatives currently underway.

### *Agriculture*

The Maragra agricultural operation performed well during the year, recording an increase in both yield per hectare and sucrose content. Stable weather conditions during the season resulted in increased efficiencies in harvesting and haulage operations.

### *Sugar production*

The factory operated consistently throughout the year. Good cane quality, combined with significantly reduced stoppages due to adverse weather conditions, resulted in the completion of the season within 29 weeks, including the toll milling of cane for a nearby mill. Efficient factory performance ensured excellent recovery of sugar from cane and an increase in throughput resulting in a third consecutive year of record sugar production which amounted to nearly 81 000 tons for the season.

### *Marketing*

The domestic sugar market in Mozambique continues to grow strongly and in the year under review industry sales volumes ended almost 12% above the previous season. Driven by demand for raw sugar amongst consumers, growth in the market was experienced from all of the regions in the country, with demand in

*Maximum sales to higher priced and stable domestic markets form the basis of Illovo's primary marketing strategy.*


the central region being the most notable. It is likely that sugar from Mozambique has found its way into Zimbabwe as a consequence of the prevailing shortage in that country. Ongoing consumer expansion, particularly in the beverages and food processing sectors, also gave rise to a strong increase in the demand for refined sugar.

The industry exported the maximum available tonnage into the EU market in respect of which, effective from 1 October 2009, Mozambique is entitled to full duty-free, quota-free access, albeit at the reduced EU price.

## MARKETS

The group produces and sells a range of sugar, syrup and downstream products into domestic, regional and world markets.

Maximum sales to higher-priced and stable domestic markets form the basis of Illovo's primary marketing strategy. Currently, sales to these markets in the countries in which the group operates account for 66% of total revenue. Sales to preferential markets in the EU and US, together with those to regional markets in Africa, comprise Illovo's next most profitable markets, followed by bulk raw exports to the world market, sold on behalf of the company through SASA. Combined, sales to these markets, comprising 29 countries, contribute 34% to total revenue. Downstream products mainly developed from molasses and bagasse are produced and sold into niche markets in 85 countries to complement this strategy.

Group revenues were underpinned by strong domestic sugar sales in all countries of operation but export revenues, despite much improved world sugar prices, were negatively affected by the relative strength of the rand and on the translation of foreign subsidiary profits into rands for the season as a whole.

### Domestic markets

*Sugar*

Illovo enjoys a meaningful share of the domestic sugar markets in the countries in which it operates and domestic market sales contributed 63% of total revenue.

During the season, the SACU sugar market was essentially flat year-on-year at just under two million tons. The major suppliers into this market are the South African and Swaziland sugar industries. Minimal imports from Southern African Development Community (SADC) sugar producing countries were sold into SACU this season. Duty-paid imports declined from last year's levels and amounted to 105 000 tons.

The rationalisation of Illovo's South African operations has resulted in a more streamlined focused business and domestic sugar sales were ahead of expectations. In South Africa, 65% of total production was sold into the SACU market. Illovo is Malawi's sole sugar producer and in the 2009/10 season, domestic sales comprised approximately 66% of total sales. Zambia Sugar experienced strong demand in its domestic market with sales increasing by 10% during the year. In Swaziland, Ubombo accounted for about 35% of industry sales. Swaziland's domestic sales in 2009/10, undertaken by the Swaziland Sugar Association into the SACU market, represented approximately 54% of total sales. In Tanzania, Kilombero's total production was sold into the domestic market which benefited from improved returns due to higher regional prices. Industry sugar production in Mozambique was higher than in the previous season and Maragra's share of industry production was 32%, with around 67% of its total sales being sold into the domestic market.

*During the year, the group's preferential exports from Malawi, Swaziland, Mozambique and Zambia amounted to 277 000 tons.*

REVIEW OF OPERATIONS

Syrup is produced in South Africa and Zambia with both products being brand leaders in their respective domestic markets. Speciality sugars made in South Africa are for domestic consumption, whilst in Malawi and Zambia they 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 beverage, pharmaceutical and industrial chemical industries. Relatively small volumes of furfural and its derivatives, including Crop Guard, a furfural-based agricultural nematicide under the Agriguard range of products, as well as lactulose, are sold in the local South African market.

**Export markets**

*Sugar*

***Preferential markets***

The new preferential market access arrangements into the EU, albeit with a concomitant reduction in the minimum reference price, provided the market certainty required for Illovo to invest in significant additional sugar production capacity with a view to exporting a large portion of this additional tonnage into the EU. In Malawi, speciality sugars are produced for markets in the EU and the US, whilst Zambia also currently produces speciality sugars for the EU market. During the year, the group's preferential exports from Malawi, Swaziland, Mozambique and Zambia amounted to approximately 277 000 tons.

***Regional markets***

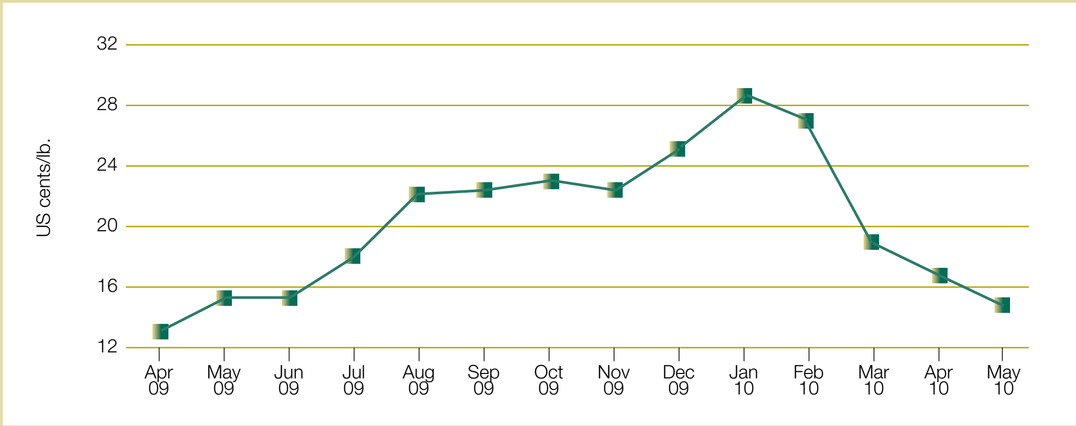
The higher average world market price and the tight supply conditions as a result of lower production in Zimbabwe had a positive impact on regional market prices. Illovo was able to take advantage of this opportunity by selling into the regional markets in Southern Africa.

More than 100 countries produce sugar around the world either from sugar beet or sugar cane. Approximately 79% of total production 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, 71% 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 world market price has historically been one of the most volatile of all commodity prices.

The five largest exporters in 2009/10, Brazil, Thailand, Australia, EU and SADC, are expected to supply approximately 93% 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 exports sugar to the world market.

The world sugar price lived up to its reputation as being one of the most volatile commodities, trading to record highs of US30 cents/lb early in the first quarter 2010, before correcting to levels below US15 cents/lb towards the end of April 2010. An improving supply position out of Brazil and India, coupled with the EU's

WORLD RAW SUGAR PRICES (monthly averages)




decision to export an additional 500 000 tons of out-of-quota exports onto the world market, has resulted in market sentiment turning around very quickly to a more bearish outlook.

The SASA export allocation for bulk sugar was around 766 000 tons, which represents 35% of total industry production for the 2009/10 season. SASA achieved an average price of US16.53 cents/lb compared to US12.77 cents/lb in the previous season, and realised approximately R2.3 billion in export proceeds.

*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 85 countries. In addition, BioMass Sugar, a liquid organic fertilizer derived from sugar cane is being sold to a growing number of international markets.

The stronger rand impacted negatively on downstream export revenues, which during the year under review, contributed R595 million to group revenue.

The directors and employees of Illovo Sugar strive to ensure that the company is managed in an efficient, accountable, responsible and moral manner.