

EXECUTIVE REVIEW

The past financial year was one of the most testing in many years for AFGRI and it is a credit to management's skill and perseverance that headline earnings from continuing operations increased by 144%.

Last year's bumper maize crop of 11,45 million tons was a mixed blessing for AFGRI. Capacity utilisation at AFGRI's silo complexes improved to 85% from 75% the previous year, but the subsequent drop in plantings for the new season – prompted by a sharp drop in maize prices due to over-supply – negatively impacted Producer Services and Financial Services. The fortunes of both these businesses are inextricably linked to the level of activity in the farming sector. Producer Services, which supplies equipment and primary inputs to the farming sector, was particularly hard hit by the decline in new maize plantings. Lower maize plantings also translated into reduced demand for crop insurance, seed, fertiliser, agricultural equipment and other inputs supplied by AFGRI.

Far more positive is how AFGRI management responded to the threats and challenges it faced over the last financial year. Logistics Services had another excellent year, due largely to the aforementioned increase in silo capacity utilisation and Products' Plant Oil business was returned to profitability. There was a 52% improvement in the performance of the Producer Services' Retail and Equipment business, following a vigorous attack on fixed costs, substantial stock reductions and the phasing out of unviable retail branches. All remaining branches are now profitable and this business is expected to make a positive contribution to earnings in the coming financial year. Another example of entrepreneurial innovation by Logistics Services is the diversification into coal transport to offset reduced maize deliveries in its transport business. Conscious of its heavy exposure to the volatile grain business, AFGRI is diversifying into new commodities such as tobacco processing and servicing of tobacco farmers.

The acquisition, after year end, of Daybreak marks the Group's re-entry to the broiler business following the sale of the 50%

interest in Earlybird in 2004 due to the restrictions placed on AFGRI by the partnership agreement with Astral. It was always the intention to re-enter this business once a suitable opportunity presented itself. This acquisition has the dual advantage of giving AFGRI a solid foothold in an expanding market segment with acceptable margins, while providing it with the opportunity for expansion. All of the suspensive conditions relating to this acquisition were fulfilled during March 2006. The sale of the Group's cotton ginning interest within Clark Cotton to Cargill subsequent to the financial year end is positive for AFGRI. AFGRI's strategic policy is to either fix or exit those businesses that do not meet its required rate of return and its exposure to the volatile cotton business was identified as a strategic threat, from which no immediate relief was seen due to continued low cotton prices and the strength of the rand. Despite continuous efforts to fix the problems at Clark Cotton, little could be done to address exogenous factors in the cotton market. Given its size and international footprint, Cargill is a more suitable home for the cotton ginning interests of Clark Cotton, which is now in a position to leverage the economies of scale indigenous to a group of its size.

Good progress was made in bedding down the relationship with AFGRI's Black Economic Empowerment ("BEE") partners, the Agri Sizwe Empowerment Trust, which acquired a 26,77% interest in AFGRI Operations in 2004. AFGRI continues to investigate ways to expand its service offering to emerging commercial farmers while continuing to service its traditional farmer market, and in this AFGRI has been ably guided by its BEE partners. Many exciting products and innovations are in the pipeline and AFGRI is determined to play a meaningful role in the transformation of the South African agricultural sector.

FINANCIAL RESULTS

The Board is pleased to report an overall increase in earnings of 19,6% and headline earnings of 8,8% on the pro forma results of the prior year. This was made possible due to the significant improvement in headline earnings from continuing operations before income tax of 19% in what can best be described as a particularly challenging year for agriculture. This was achieved on continuing sales of R5,4 billion, which was largely unchanged from the previous year. The strengthening of the South African rand, the sharp drop in realised maize prices and the resultant 45% decrease in planted hectares directly impacted the results of both the Producer Services and Financial Services businesses.

Sales in Financial Services' continuing operations increased 38% to R572 million (2005: R413 million) though headline earnings from continuing operations before income tax declined by 13% to R45 million (2005: R52 million) due primarily to lower demand for crop insurance. Logistics Services increased sales 13% to R294 million (2005: R260 million) and headline earnings from continuing operations before income tax by a creditable 20% to R202 million (2005: R169 million). Products' headline earnings from continuing operations before income tax remained largely unchanged at R66 million (2005: R67 million).

STRATEGY

AFGRI's business strategy is to achieve real economic growth by maximising returns on shareholder capital and to fix or exit those businesses that destroy value. AFGRI's re-entry to the broiler business, through the acquisition of Daybreak and the disposal of the cotton ginning interests within Clark Cotton, is consistent with this philosophy. AFGRI also seeks to capture a larger share of the agricultural value chain by reducing its exposure to the vagaries of commodity prices. Since embarking on a major restructuring of the Group four years ago, value-destroying businesses that could not be fixed have been sold and new business opportunities with solid potential for value creation have been pursued both in South Africa and beyond. Today, AFGRI is a diverse agricultural services group offering the full-spectrum of agricultural, logistics and financial services to clients.

OPERATIONAL REVIEW

AFGRI LOGISTICS SERVICES

This business unit comprises:

- Handling & Storage, with more than 4 million tons of fixed and mobile capacity countrywide; and
- Logistics, a fourth party supplier of logistic services, as well as fleet management and owner-driver solutions.

This business increased sales by 13% to R294 million (2005: R260 million) and headline earnings from continuing operations before income tax by a creditable 20% to R202 million (2005: R169 million).

HANDLING & STORAGE

This is the largest supplier of handling and storage services to the South African agricultural community, and represents nearly a third of South Africa's total silo capacity of 14 million tons. Capacity utilisation over the past financial year exceeded 85%, up from 75% for the prior year, helped by a bumper maize crop of 11,45 million tons. The bumper maize crop resulted in a surplus of roughly 5 million tons, and many farmers opted to store rather than sell their surplus crops due to the slump in the maize price.

AFGRI's silo capacity has been augmented by the introduction of non-permanent "bunker" silos, which can be erected at relatively low cost in areas of greatest demand.

The reduction in maize plantings for the current season is likely to result in lower capacity utilisation during the coming financial year.

LOGISTICS

Logistics managed the transportation of 3,2 million tons of product last year, almost a 50% increase over the prior year. It remains the single largest transporter of grain products in South Africa. As a fourth party logistics provider, this business owns very little in the way of assets, relying on the services of outsourced suppliers and hauliers.

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The 2 million tons of grain transported was down 10% on the previous year, but this was more than offset by the 1,2 million tons of coal shipped. AFGRI is in the process of converting several grain sidings to coal sidings and is confident of expanding this new business opportunity in the coming year.

AFGRI FINANCIAL SERVICES

This business is one of the biggest financiers of the agricultural market and the biggest financier of the milling industry in South Africa. It comprises:

- Finance facilities, providing loans and seasonal accounts to about 19 000 farmers and agri-processors;
- Trading, one of the three leading grain traders in South Africa; and
- Insurance, the largest crop insurance brokers in South Africa.

Sales in Financial Services' continuing operations increased 38% to R572 million (2005: R413 million) as a result of the much improved performance in Africa (Zambian and Malawian businesses). Headline earnings from continuing operations before income tax declined by 13% to R45 million (2005: R52 million) due primarily to lower demand for crop insurance.

FINANCE FACILITIES

This business provides financial facilities and products to approximately 19 000 farmers and agri-processors. The average debtors' book was R3,1 billion (2005: R2,9 billion), with a bad debt experience of around 1%. The types of loans provided range from seasonal to term loans.

TRADING

The Trading business posted a strong performance due mainly to higher trading on SAFEX by clients, translating into higher brokerage income, increased milldoor grain supplies and the launch of an innovative new product. This business provides farmers and agri-processors with an efficient pricing mechanism and achieved trading volumes of 2,1 million tons (2005: 1,8 million tons), an increase of 17%. The Trading business does not take on any principal risk, nor does it speculate on future price movements. It is a fee-earning business and revenue is dependent on trading volumes transacted on behalf of clients.

INSURANCE

Demand for crop insurance was sharply down due to the reduction in maize plantings. Farmers are expected to increase plantings in the coming season due to the current increase in maize prices and this should result in a recovery in demand for crop insurance.

AFGRI PRODUCER SERVICES

This business comprises:

- Retail
 - Retail and Equipment, with over 80 retail outlets supplying requisites and equipment to farming communities across the country;
 - Partmaster, a national supplier of agricultural machinery parts and components; and
 - Technical Services, which offers leading-edge technology to assist farmers in optimising returns.
- Primary Inputs, supplying fertiliser, chemicals, fuel and seed to farmers; including Tsunami Crop Care, which sources and formulates cost-effective agro-chemicals for distribution by agents.

RETAIL AND EQUIPMENT

Retail and Equipment comprises a network of some 80 stores servicing farming communities across the country. This business also services the equipment needs of farmers through the retail network, as well as through 30 workshops and 23 mobile units.

Sales for the Retail and Equipment business, at R2,2 billion, were constant with the previous year, and the headline loss from continuing operations before income tax at R48 million was an improvement of 52% on the R99 million loss for 2005. This loss disguises the strong improvement in the Retail and Equipment businesses in recent months and the actions taken to return these businesses to profit.

The retail network was adversely impacted by the 45% reduction in summer maize plantings. The improvement in operating performance over the prior year was due to the phasing-out of loss-making branches, a 25% reduction in fixed costs and a much tighter stock control.

The outlook for Retail and Equipment going forward is positive, for several reasons:

- the recent recovery in the maize price is expected to translate into higher maize plantings in the forthcoming season;
- most dams are full to capacity, which contributes to an improved outlook for agriculture; and
- all retail outlets within the Group are now trading profitably following the phase-out of loss-making stores and the reduction in fixed costs.

There are ongoing efforts to streamline IT systems throughout the retail network, reduce infrastructure costs and improve margins through more efficient procurement and supply chain management.

The Golf and Industrial business specialises in golf course and industrial turf equipment. The prospect for the supply of John Deere equipment to the more than 20 new golf courses under development across the country are good.

PARTMASTER

Previously known as Kramp South Africa, Partmaster has a proud history going back more than 20 years in South Africa servicing the agricultural machinery industry by stocking and supplying a wide range of parts and components for the agricultural community. Partmaster retains the exclusive right to products available from the Kramp group suppliers and plans to expand its range of products available to AFGRI clients during the coming year.

TECHNICAL SERVICES

Technical Services is a market leader in precision farming, a scientifically-based technique that removes the guesswork associated with traditional farming. It continues to make steady inroads among larger commercial farmers eager to reduce input costs and maximise yields. This business provides satellite imaging capabilities over most of South Africa's crop producing regions and offers farmers an early view of any crop stress they will be experiencing so that corrective action can be taken.

EXECUTIVE REVIEW (continued)

PRIMARY INPUTS

The headline loss from continuing operations before income tax of R44 million (2005: R8 million) is due to the poor performance of Seed. It was another difficult year for Seed due to the near 45% reduction in maize plantings, itself a result of much lower maize prices. The launch of high-yield yellow maize hybrids in the last two years has been well received by the market. The recent recovery in maize prices augurs well for the coming planting season and an increase in maize plantings is anticipated. This will be to the benefit of Seed in the coming financial year. The Seed business continues to research new hybrids for wheat, sunflower, soya beans and other grains.

Tsunami was launched during the previous financial year to offer AFGRI clients more competitive prices on generic agro-chemicals and technical advice on the optimum application of these chemicals to maximise yields and minimise environmental damage. This business has performed well since start-up, although demand for agro-chemicals suffered due to reduced grain plantings, a situation which should improve markedly in the coming year. New product formulations currently in the pipeline, including a joint venture with a major domestic chemical producer, will expand the range of products available to AFGRI customers and expand the Group's market share.

AFGRI PRODUCTS

AFGRI Products comprises:

- AFGRI Animal Proteins, with Feeds being one of the three largest producers of animal feeds in South Africa;
- Foods and Plant Oils; and
- Clark Cotton.

ANIMAL PROTEINS

AFGRI Animal Feeds comprises six manufacturing facilities at Eloff, Isando, Bethlehem, Kinross, Paterson in the Eastern Cape and Klipheuwel in the Western Cape. It has a total production capacity of 1,2 million tons a year, which makes it one of the three largest animal feed businesses in South Africa.

Animal Feeds achieved headline earnings from continuing operations before income tax of R71 million during the year under review, which is 8% down from that of the previous year. Headline earnings growth was impacted by start-up costs associated with the new Western Cape plant and the closure of a facility (part of the Natalagri acquisition) due to low capacity utilisation. This is a creditable result in the light of the unusually high costs associated with the closure and Western Cape start-up.

A new factory in Paterson in the Eastern Cape was commissioned during the year under review and is now operating profitably. This joint venture with the Eastern Cape Agricultural Co-op expands AFGRI's animal feed production by about 8% and, together with the new Western Cape plant, extends the national footprint of the Animal Feeds division. The acquisition of the Daybreak broiler business secures current feed offtake and provides AFGRI with an expansion opportunity for Animal Feeds, the benefits of which will reflect in the results for the current financial year.

In last year's annual report, reference was made to a venture between Animal Feeds and Carr's Milling Industries plc, a UK listed agri-business with operations very similar to AFGRI. This venture would establish a joint manufacturing facility in the UK to produce technologically advanced bypass protein for inclusion in ruminant feed which has been developed and licensed by AFGRI. This joint venture is now well advanced, and the production plant is due to be commissioned in the second half of the current calendar year, at a total cost of R6 million.

FOODS AND PLANT OILS

The Foods business comprises Citrifruit, which extracts and refines high quality citrus oil for supply to the beverage market and is a supplier of lemon oil to the largest branded soft drinks supplier in the world, and a Snacks business.

The Plant Oils business comprises Cotton Seed Processors and Nedan Oil Mills, which supply plant oils and soya-based products from a manufacturing plant in Mokopane.

Sales of the Foods and Plant Oils businesses increased by 180% to R375 million (2005: R134 million) due to the acquisition of Nedan Oil Mills. The headline loss from continuing operations before income tax was R5 million (2005: R10 million loss) and was primarily due to the poor performance of Citrifruit. This operation was negatively impacted by low production due in part to the drought affecting the citrus harvest in the Lowveld.

CLARK COTTON

AFGRI's cotton ginning interests within Clark Cotton, comprising three gins in Zambia, three in South Africa and a 51% interest in two gins in Malawi, were sold to Cargill subsequent to the close of the financial year under review. The total proceeds of the transaction is approximately R259 million. Cargill paid US\$15 million for the fixed and intangible assets of Clark Cotton. It also acquired at book value the inventory and will collect the outstanding debtors of Clark Cotton in Zambia and South Africa, as well as procure the repayment of the working capital loans to Clark Cotton Malawi.

As mentioned in the previous annual report, the South African market for cotton lint has been severely disrupted in recent years by low cost imports of manufactured garments from China, placing Clark Cotton's margins under severe pressure. Despite efforts to lower costs, reduce investment in working capital and adjust the business' hedging policy, these were not sufficient to offset lower cotton prices and currency translation effects emanating from the strong rand and Zambian kwacha. A decision was therefore taken to exit this business and redeploy the capital realised more profitably elsewhere.

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AFGRI INTERNATIONAL

This business comprises the Group's operations in Australia and Zambia.

T&H Walton Stores, the largest distributor of John Deere farming equipment in Western Australia, had another excellent year, with equipment sales buoyed by good crop yields.

The Zambian business is a replica of AFGRI's South African operations and is involved in the handling, grading, storage, marketing and trading of grain. Zambia has become an African success story, helped by rising copper prices and a resurgent agricultural sector. Many displaced former Zimbabwean farmers have been welcomed with open arms in Zambia, helping to turn this country into a net food producer.

PROSPECTS

Following the Group's sale of the Clark Cotton ginning interests, the re-entry into the broiler business and the restructuring of the Producer Services business, AFGRI has built an excellent platform for growth over the coming financial year. As mentioned earlier, the recent recovery in the maize price to about R1 100 a ton from below R600 last year and the lower current crop suggests maize plantings will return to normal levels in the forthcoming season. This will have a positive effect on virtually all areas of the Group's business. The lower summer crop is, however, expected to have a negative effect on the capacity utilization in the Handling & Storage business.

A recovery in the fortunes of the agricultural sector – helped by excellent rains and near record dam capacities – should reflect in the financial performance of the Financial Services, Products and Producer Services businesses.

We continue to look for opportunities to expand our geographical footprint and capture a larger share of the agricultural value chain through appropriate acquisitions that meet AFGRI's strategic objectives. Having weathered the extremely difficult past year, we are confident of a much improved performance in the year ahead.



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