



Share Code (JSE)	AFX				
Share Code (NSX)	AOX				
Current share price (cps)	3130				
Shares in issue (m)	308.6				
12-month avg value traded (m)	R138.7				
Return on equity (2006)	49.6%				
Recommendation	HOLD				
	2004	2005	2006	2007E	2008E
	Rm	Rm	Rm	Rm	Rm
Revenue	7,835	5,754	3,914	5,014	5,872
% change		-26.6%	-32.0%	28.1%	17.1%
Profit before taxation	1,194	2,069	1,181	970	1,169
% change		73.3%	-42.9%	-17.9%	20.5%
Net profit	614	1,350	858	628	735
Net margins	10.2%	25.1%	22.1%	12.7%	12.7%
Basic earning per share (cps)	179.2	403.5	278.1	203.6	238.3
Dividends per share (cps)	64.0	495.0	148.0	108.4	126.8

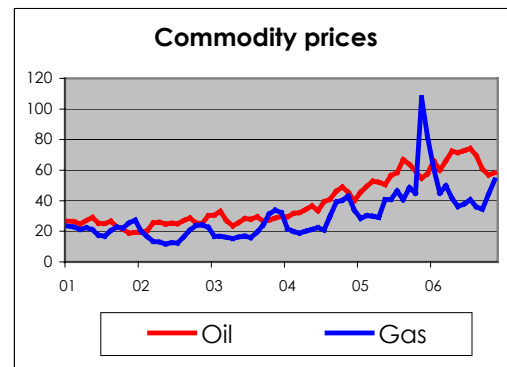
The concerns with regards to the possible shortage of electricity, has placed increasing emphasis on alternative sources of energy, specifically gas. In the Western Cape, families are being given new gas stoves in return for their old electric appliances in an effort to reduce the demand for electricity. A second initiative in South Africa, which will lead to increased demand for gas, has been undertaken to improve safety by replacing old paraffin burners with gas-powered appliances.

Also, with the recent increases in the price of petrol, consumers are raising questions about the viability of using gas-powered motor vehicles. These have been highly successful in Europe for many years, as well as the use of

gas stoves and gas geysers, to minimise the demand for electricity.

Liquid petroleum gas ("LPG") is a by-product in the process of refining oil, therefore, the price of gas follows the oil price.

The prices of gas and oil have moved in tandem since 2001. There are increases in the gas price every year during December and January, as a result of the Northern Hemisphere winter, where gas is used extensively for heat-generation.



Source: I-Net Bridge, SSS Research

This was exacerbated at the end of 2005 and early 2006 due to the electricity shortages experienced in the Western Cape when the Koeberg power plant had to be repaired. This led consumers to increase their demand for gas. During this period, a gas shortage occurred as well when refineries in South Africa experienced

unplanned shutdowns. The gas price seems to have stabilised recently and has moved closer to the oil price.

Afrox

Afrox purchases LPG mainly from the refineries in South Africa and distributes to their clients.

As a result of the unexpected LPG shortages experienced recently, Afrox is in the process of building storage capacity so that larger volumes of gas can be held in reserve. Afrox has an expansion plan which will see approximately R500m being invested in capacity building. This will lead to an increase in depreciation of approximately R33m per year. Most of these projects will be completed during the financial year ending 30 September 2007 and the balance during the following financial year.

Afrox has also acquired Refrigeration Equipment Company ("Reco") for R120m. At present, the Competitions Commission is in the process of approving the take-over and management is hoping to start the process of integration in December 2006. Revenue amounting to R240m is expected during the 2008 financial year. This acquisition points to an effort to grow the refrigeration side of the business.

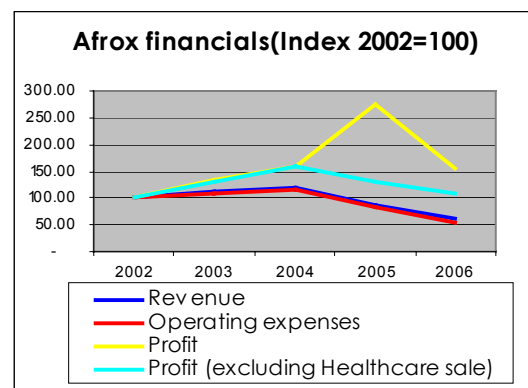
Structure

Since 1935, BOC have owned a controlling interest in Afrox. During

March 2006, the German Linde group put in a bid to buy out the BOC group (which owned 50.47% of Afrox). This bid was accepted by the shareholders of the BOC group, during August 2006 and the take-over became effective on 5 September 2006. Management of Afrox are not expecting too many organisational changes as a result of this take-over.

During the 2005 financial year, Afrox sold the majority of its 68% holding in Afrox Healthcare, to a BEE consortium led by Brimstone Investment Corporation and Mvelaphanda Strategic Investments, while selling the remaining 20% during the 2006 financial year. This sale has reduced the top line substantially and has returned the focus to the industrial side of the business.

Financials



Source : AFX annual reports, SSS Research

The revenue of Afrox has decreased 40.0% over the past five years (i.e. an effective decrease of 9.7% p.a.). This is as a result of the sale of Afrox Healthcare, which contributed approximately 40% of the top line.

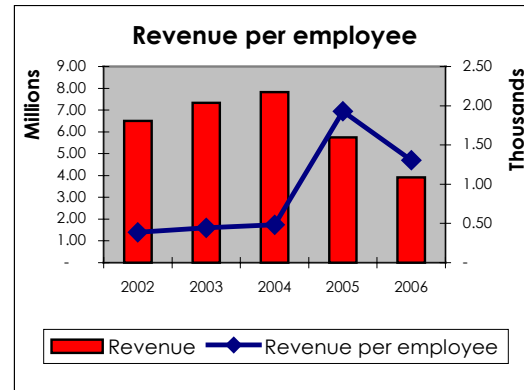
Similarly, the operating expenses have decreased by 11.2% p.a. over the five-year period.

This combined effect has resulted in very strong profits increasing by 57.2% (i.e. an effective increase of 9.5% p.a.) over the past five years. The profit figure, however, includes the revenue generated by and the profit on the sale of Afrox Healthcare.

If we strip out the revenue generated by Afrox Healthcare, the profit from the industrial operations has grown by approximately 8% p.a.

At the recent results presentation, Afrox reported that its headline earnings per share ("HEPS"), from the industrial operations only, increased by 19.1% from 118.9cps in 2005 to 141.6cps in 2006. Non-recurring items, of which the greatest portion was a pension fund contribution holiday, accounted for 12.9cps in the current year and if this were stripped out, the HEPS grew by 7.9% over the one-year period.

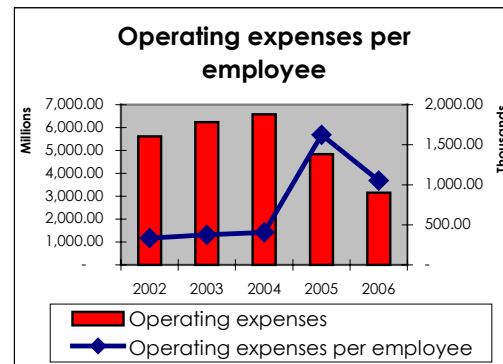
Revenue has fallen from R6.5 bn in 2002 to R3.9 bn during 2006. Revenue has dipped since its 2004 high at R7.8 bn as a result of the Afrox Healthcare sale. The revenue earned per employee was relatively flat between R387k and R485k for the period 2002 to 2004. This figure then increased to R1.9m per employee in 2005 and subsequently reduced to R1.3m per employee during 2006.



Source : AFX annual reports; SSS Research

This substantial growth coincides with a significant decrease in the number of staff members (approx. 13 000) as a result of the Afrox Healthcare sale.

The shortage in the supply of LPG during the financial year resulted in a loss of revenue amounting to R25m – R30m.



Source : AFX annual reports; SSS Research

The operating expenses have followed a similar trend to the revenue by decreasing from R5.6bn during 2002 to R3.1bn during 2006.

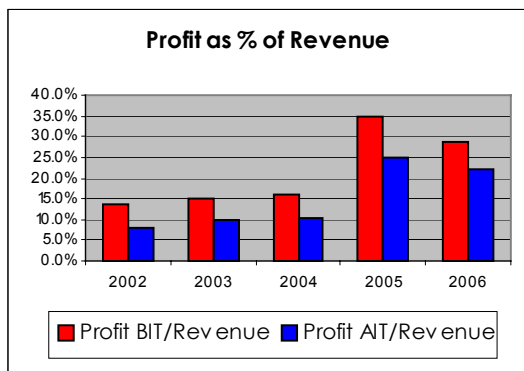
The operating expenses per employee during 2002 was R334 000 and remained relatively constant until 2005 when it grew to R1.6m per employee

and a subsequent slowdown was observed to R1.1m during 2006.

This significant increase was also due to the reduction in the number of staff members due to the sale of Afrox Healthcare.

During the 2006 financial year, the operating expenses in respect of industrial operations only, increased by 20.4%, adding R548m. This was mainly caused by the increase in the cost of supplying LPG as a result of the increase in the oil price as well as the price of transport.

Further to this, during the financial year, Afrox imported their first shipment of LPG which has become a permanent feature. Should the exchange rate weaken from its current levels, the operating expenses will be negatively impacted.

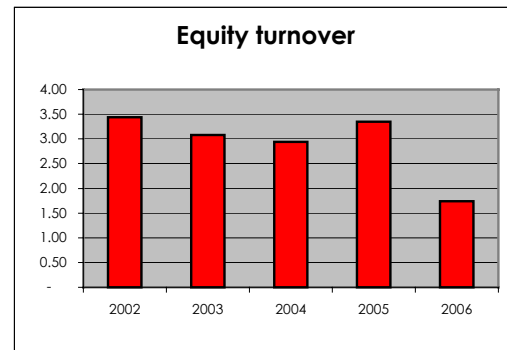


Source : AFX annual reports; SSS Research

During 2002, 13.5% of the revenue was converted into profit before interest and tax, while 7.8% was converted into profit after interest and tax. At the end of the 2005 financial year, this figure had increased to 34.8% of revenue being converted into profits before

interest and tax, while Afrox Healthcare converted 20.1% of its revenue into profit before interest and tax during 2005.

For the group 25.0% of revenue was converted into profit after allowing for interest and tax during 2005 and during the 2006 financial year, these figures have slowed slightly to 28.5% and 22.1% respectively. The unexpected increase in the price of LPG as well as the increase in the price of transport has resulted in the reduction of the margins during 2006.

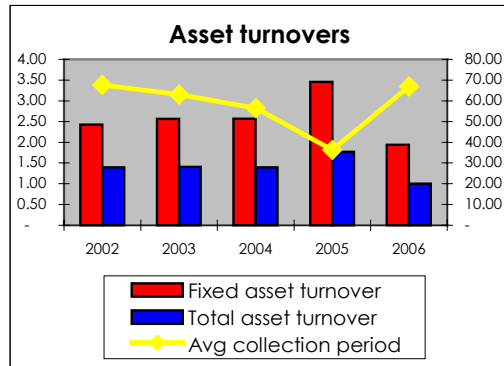


Source : AFX annual reports; SSS Research

The equity had been turned over by more than three times (3.44) during 2002, but this ratio has subsequently fallen. The largest reduction was from 3.40 during 2005 to 1.74 in 2006 and is mainly as a result of the revenue and profits growing at a slower pace than the equity.

The fixed asset turnover has grown from 2.42 during 2002 to 3.46 in 2005. This growth has resulted from the sale of an investment of the business during the 2005 financial year and the resulting decrease in fixed assets.

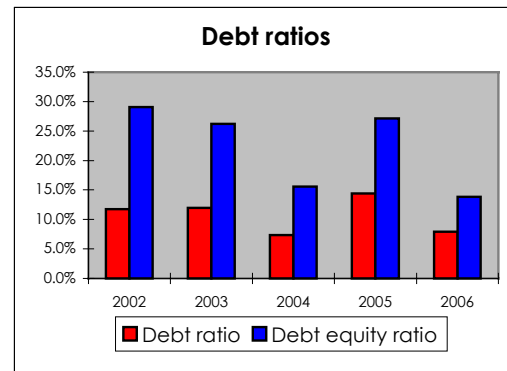
For this reason the total asset turnover has decreased 28.2% over the five year period from 1.39 during 2002 to 1.00 at the financial year end 2006.



Source : AFX annual reports; SSS Research

The average collection period of accounts receivable has reduced over the five-year period from 67.7 days in 2002 to 61.9 days in 2006. A sharp decline occurred during 2005 as a result of the sale of Afrox Healthcare and subsequent decrease in trade receivables, however, the average collection period increased again during 2006. This increase resulted from a combination of the decline in the top line as well as an increase in the absolute value of the trade and other receivables.

The debt ratio (i.e. debt to total assets) registered 11.8% during 2002 and this ratio has fluctuated since then until reaching its highest level at 14.4% during 2005. During the financial year ended 30 September 2006, debt amounted to 7.9% of the assets. Debt has fallen by approximately 40% since 2002 with most of this drop occurring between 2005 and 2006. This is also as a result of the sale of Afrox Healthcare.

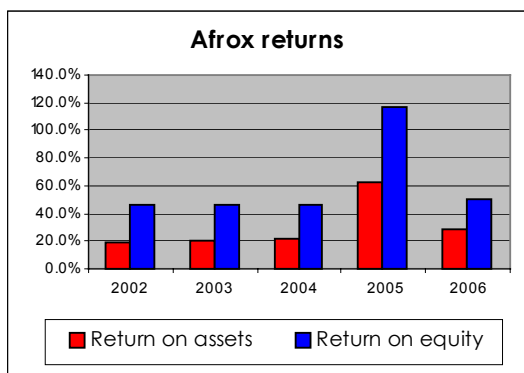


Source : AFX annual reports; SSS Research

The ratio of debt to equity has followed a similar pattern registering 29.1% during 2002 and reaching 27.1% during 2005. During the 2006 period the gearing has been reduced considerably and has registered 13.8%. We would expect to see these ratios increasing alongside Afrox's expansion program as most of this program will be funded through debt.

The profit from operations covered the financing costs 5.6 times during 2002. This figure increased to 12.7 times during 2004 and during 2006, the financing costs were covered 31.9 times by the profit from operations. We would expect to see this rate decline in future as a result of the increased debt being serviced at higher interest rates as well.

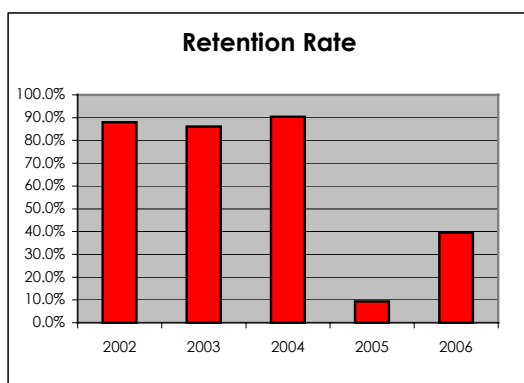
The return on assets was relatively constant during the period 2002 (18.8%) to 2004 (22.0%). It grew to 61.9% during 2005 as a result of the sale of Afrox Healthcare and has fallen to 28.5% during 2006. The return on equity followed a similar trend registering 46.6% during 2002 as well as during 2004. The return grew to 116.8% during 2005 and fell to 49.6% during 2006.



Source : AFX annual reports; SSS Research

As mentioned above, the large increase in the 2005 return is as a result of the sale of Afrox Healthcare.

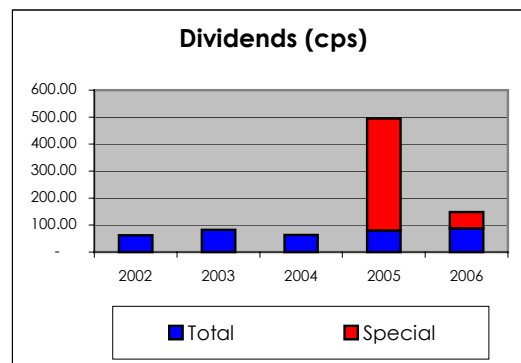
The rate of operating profit, not distributed by way of dividends, was 88.0% during 2002. This decreased to only 9.4% as there was a large dividend paid during the 2005 financial year. This dividend was declared in respect of profits made during the sale of Afrox Healthcare.



Source : AFX annual reports; SSS Research

The retention rate during 2006 increased again to 39.4%, however, this is still a fairly low level resulting from the distribution of a special dividend granted. We expect to see a retention rate between 75% and 80% during the next financial year.

A dividend of 148cps (i.e. a total dividend of 88cps and a special dividend of 60cps) was declared for the year, translating into approximately 60% of the earnings being retained and reflecting a dividend cover of 2.18x.



Source : AFX annual reports; SSS Research

The dividend, excluding the special dividend, was increased by 10% from the prior year's 80cps declaration and we expect this to continue going forward as Afrox has been able to maintain an average increase in dividends, since 1995, amounting to approximately 12%.

Outlook and valuation

The Afrox strategy is to sustain the core business and use strong infrastructure growth to expand.

We believe that Afrox is consistent with growth potential. Afrox has also received a very good global credit rating of A1+ on the short side and AA- on the long side.

Great emphasis is being placed on growing capacity to ensure that profitability is not affected by a shortage of LPG.

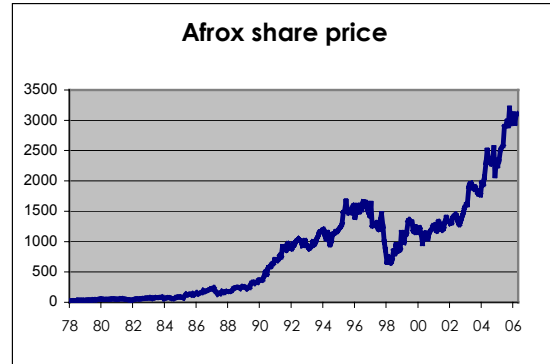
The safety business, is also receiving attention, as the margins at present are still low. This business is in its infancy stage and there is potential for expansion. This expansion should have a positive effect on the margins.

A further positive impact will be exerted on Afrox with the large investments in infrastructure which will be taking place in South Africa leading up to the Soccer World Cup in 2010.

With the take-over by Linde, Rick Hogben was appointed as the leader of the Regional Business Unit, Africa, however, Rick will be retiring at the end of March 2007. His successor has not yet been named. There have been movements in top management but most of the individuals have been replaced from within the business.

Management seems driven and is committed to growing the business at a rate 50% higher than nominal GDP.

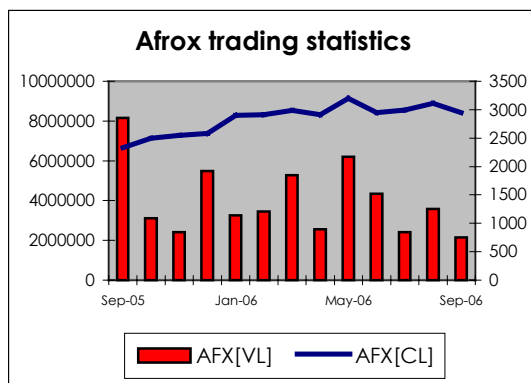
The Afrox share price has grown exponentially moving from 660cps during 1998 to 3085cps at the end of October 2006.



Source: I-Net Bridge; SSS Research

The average PE of Afrox since 1994 is 13.1. Based on this PE and the projected earnings of 204cps, Afrox is trading at an 18% premium to a 2658cps valuation.

Our DDM, using a projected dividend of 108.4cps, indicates a share price of 2691cps. Our recommendation is therefore HOLD.



Source: I-Net Bridge; SSS Research



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