An Analysis of the Financial Performance of State Owned Enterprises

public enterprises
Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

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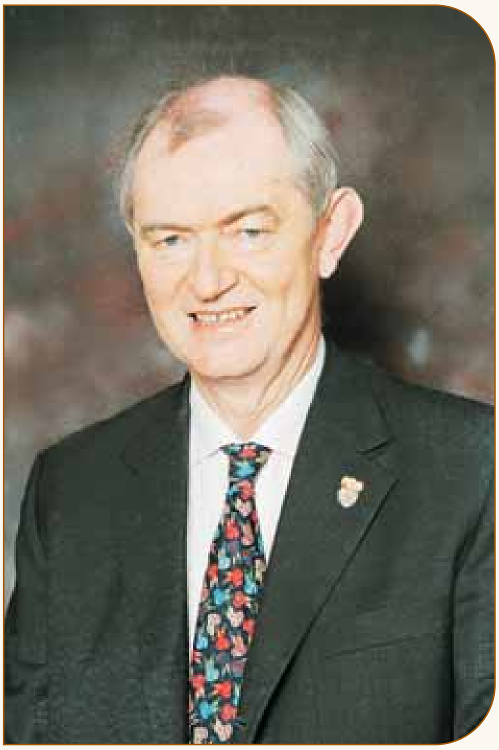
Contents



Alec Erwin
Minister of Public Enterprises

Foreword to the Five Year Review

Each of the State Owned Enterprises (SOE) that report to the Department of Public Enterprises provides annual financial statements containing all the relevant information on their operations. These enterprises play an important role in the economy and more particularly in the present period.

It therefore seemed useful to collate this information into a single presentation that tracks the performance over the last five years. This provides both an aggregated performance indicator and indicates the trials and tribulations of specific SOE over the period.

We hope that this will be of interest and use to observers of the economy, as they gauge the capacity of the SOE to play a leading role in investment and in improving the efficiency of the economy.

Alec Erwin, M.P.
Minister of Public Enterprise

Overview by the Director-General

Portia Molefe
Director-General

A phenomenal R370 billion has been set aside for infrastructure spend generally, for the next three years. This amount is set to increase as South Africa moves towards a 6 percent growth trajectory as outlined in the Accelerated and Shared Growth Initiative of South Africa. Prudent accountability and transparency in respect of the management, allocation and impact of valuable state resources is thus essential.

The Department of Public Enterprises (DPE) as shareholder manager for seven state owned enterprises (SOE), will monitor SOE performance with regard to infrastructure investment and delivery, operational and industry efficiency, financial and commercial viability, and governance and regulatory compliance. Shareholder compacts around strategic performance indicators are being developed to ensure a common understanding of expectations and to maximise output value.

SOE accountability, however, is not confined to the Department of Public Enterprises, nor the broader state, but is extended to every citizen of this country and every contributor to the South African economy. As a demonstration of our commitment to transparency and accountability, the DPE has conducted a review of SOE spend over the past five years. The exercise aided us to identify areas of excellence and well as areas for improvement. The areas of excellence will be replicated and more stringent monitoring and governance mechanisms are being put in place to address systemic challenges.

The publication forms a good basis for general engagement on SOE functioning. Future publications will focus on performance in more detail. We hope that the publication will increase the interest of the public in the contribution of SOE and will open a channel for feedback on how we can improve.

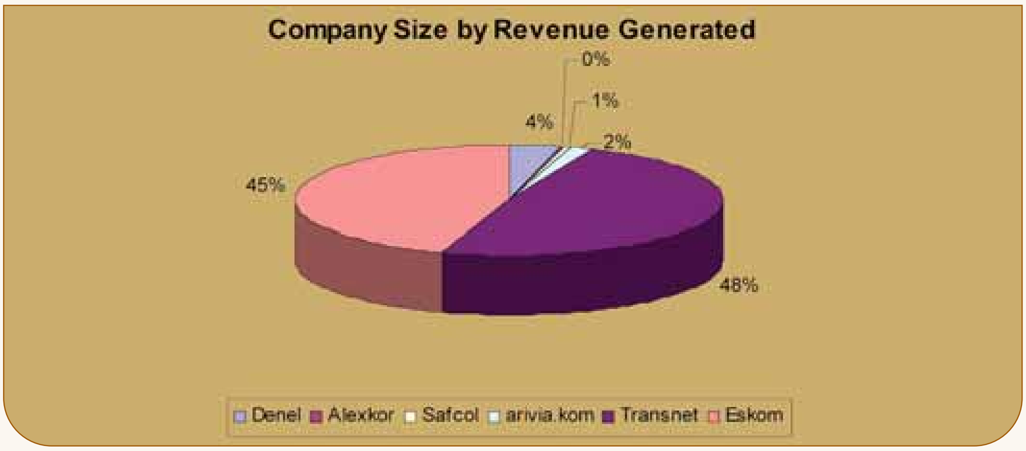
PMolefe

Portia Molefe
Director-General

Introduction

As its primary mandate, the Department of Public Enterprises provides oversight and strategic direction for the State Owned Enterprises (SOE). This involves critical analysis of the operations and performance of the SOE, focusing on increasing infrastructure investments by SOE, improving the operational efficiency and contributing to competitiveness, broad-based empowerment, research and development and training. The Department advises on the SOE through their operational efficiency and investment programmes.

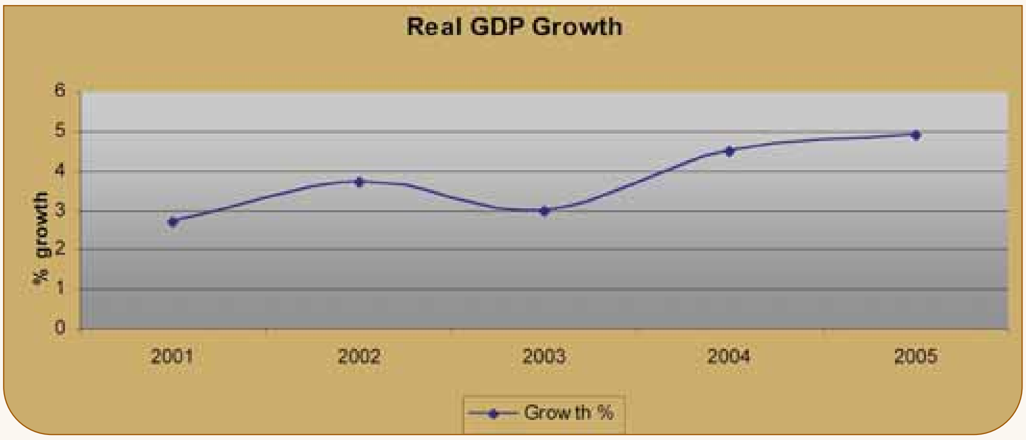
The SOE in which the DPE is a direct shareholder include Transnet, Eskom, Denel, Alexkor and SAFCOL. The ultimate shareholdering of arivia.kom is held through the shares by Eskom, Denel and Transnet. The relative size of the companies by revenue contribution is illustrated below:



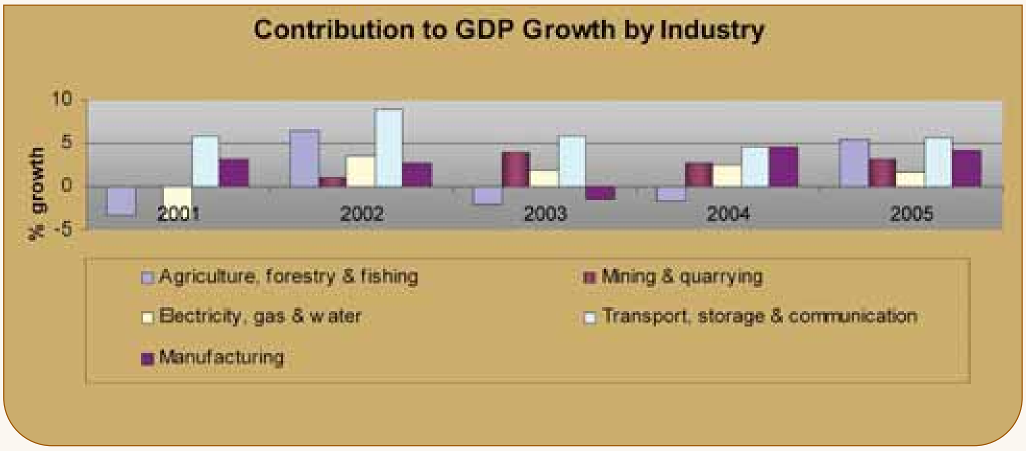
This report, based on audited results, reviews the performance of the SOE over a five-year period from 2001 to 2005.

Macroeconomic Review

The South African economy recorded accelerated growth over the period of review with Gross Domestic Product (GDP) growth reaching 4.9% in 2005.

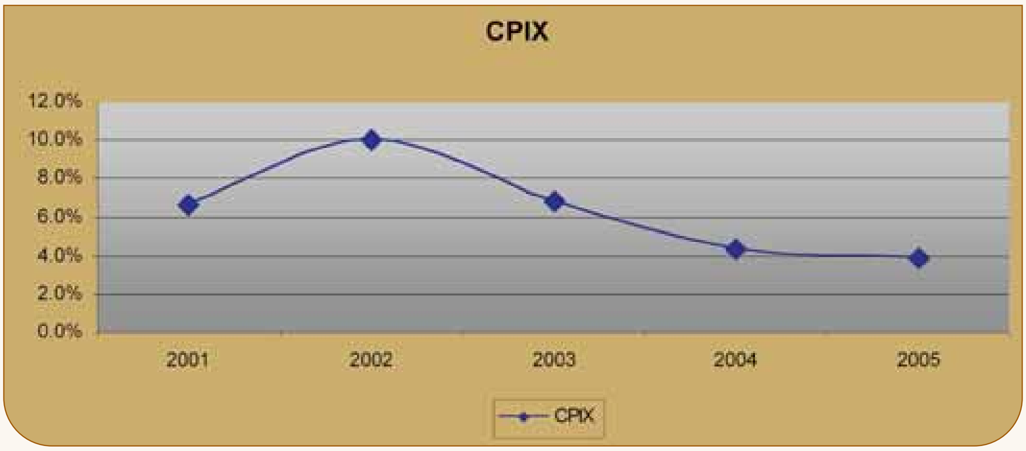


The contribution to GDP growth by the industries in which these SOE operate is depicted in the following graph:



The transport industry's contribution declined in 2003 and 2004 but recovered slightly in 2005. Growth in forestry tended to fluctuate; a sharp decline in 2003 followed by a strong recovery in 2005. The electricity and mining industries showed strong growth through to 2003 with a subsequent slow-down in 2005.

Consumer price inflation (CPI) followed a downward trend from the peak of 10% recorded in 2002, declining to 3.9% in 2005. The rise was largely due to the combination of a sharp deterioration in the value of the Rand late in 2001, along with high international food price inflation, driven by adverse global weather conditions. However, a recovery in the value of the Rand lead to a declining trend in CPIX inflation from late 2002.



The steady decline in inflation rates over the long term brought about lower levels of domestic interest rates. This coupled with the government's significant reduction in borrowing requirements lead to lower domestic capital market rates.

A number of improvements in South Africa's credit ratings were recorded from 2001. In November 2001, the international credit rating agency Moodys raised South Africa's long-term foreign currency debt rating to BAA2 and the government's domestic debt rating to A2. In August 2002, Fitch Ratings revised its outlook on South Africa's foreign currency debt from "stable" to "positive". In May 2003, Standard and Poor's (S&P's) raised its long-term currency rating from "BBB-" to

"BBB" and its local currency ratings from "A-/A-2" to "A-/A-1". In their latest ratings, Moodys rated Eskom at A2 while S&P's rated it at BBB. Fitch Ratings rated Denel at AA.

Comparative Financial Information

The table below illustrates the SOEs' financial performance over the period of review.

R 'million	2005	2004	2003	2002	2001
Transnet					
- Turnover	46 259	43 637	41 278	35 811	31 740
- Growth %	6%	6%	15%	13%	15%
- Operating profit/(loss)	5 818	187	5 088	1 463	1 704
- Net profit/(loss)	6 810	(6 332)	(421)	3 915	3 653
Eskom					
- Turnover	42 984		32 848	29 684	26 112
- Growth %	31%		11%	14%	7%
- Operating profit/(loss)	8 911		6 818	8 321	6 703
- Net profit/(loss)	5 197		3 534	3 739	2 561
Denel					
- Turnover	3 784	4 442	4 372	3 904	3 621
- Growth %	-15%	2%	12%	8%	5%
- Operating profit/(loss)	(1 392)	62	203	(286)	41
- Net profit/(loss)	(1 604)	(377)	(73)	(363)	24
Alexkor					
- Turnover	191	265	292	288	269
- Growth %	-28%	-9%	2%	7%	22%
- Operating profit/(loss)	(11)	35	44	16	(32)
- Net profit/(loss)	(16)	36	6	2	(45)
SAFCOL					
- Turnover	641	682	677	692	645
- Growth %	-6%	1%	-2%	7%	12%
- Operating profit/(loss)	333	63	97	44	41
- Net profit/(loss)	252	43	94	33	32
arivia.kom					
- Turnover	1 594	1 728	1 516	1 728	
- Growth %	-8%	14%	25%	14%	
- Operating profit/(loss)	85	91	65	28	
- Net profit/(loss)	63	56	65	56	

Turnover

At the end of the 2004/05 financial year (FY), Denel, Alexkor, SAFCOL and arivia.kom achieved turnover growth rates lower than inflation rate. Denel's turnover was negatively impacted by the strengthening of the Rand as more than 50% of its earnings are in foreign currency. The reduction in Alexkor's turnover can be attributed in part to declining production levels and also to the strengthening of the Rand. SAFCOL disposed a number of its operating assets over the period and this led to the reduction in turnover. arivia.kom also suffered a decrease in revenue during this FY, the first decline since its inception in 2002. This was mainly due to a highly competitive IT market, longer than expected lead times in Africa and the effect of the cost cutting exercise at Transnet.

It is important to note that Eskom's financial year-end changed from 31 December 2004 to 31 March 2005 resulting in a 15-month reporting period for this financial year during which a 31% turnover growth rate was achieved. Transnet also achieved above inflation rate turnover growth.

Profitability

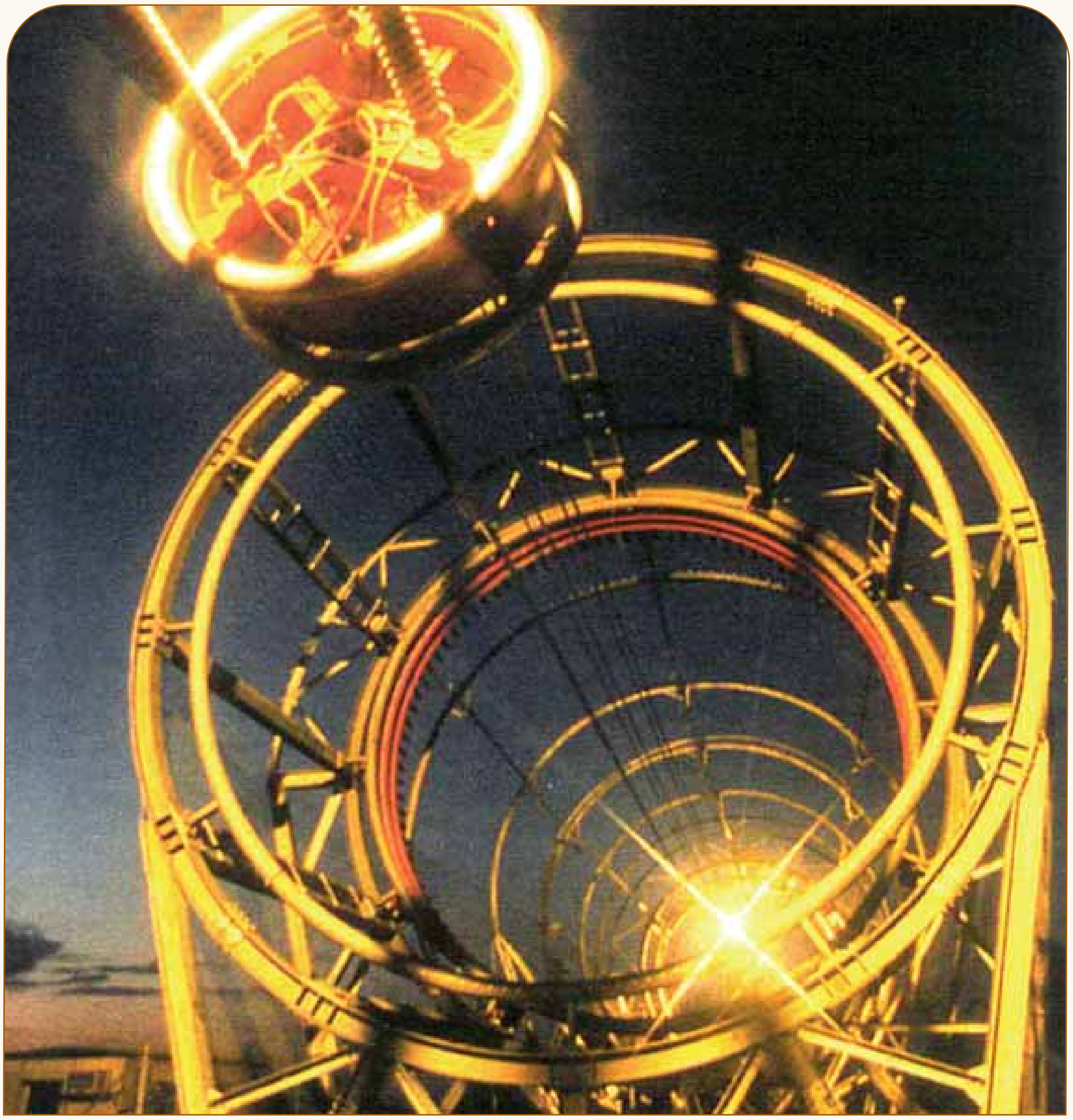
Eskom, SAFCOL and arivia.kom achieved profits consistently during the review period. Following losses recorded in FY 2002/03 and FY 2003/04, Transnet achieved net profit of R6 810 million in FY 2004/05. Denel's financial performance declined and it recorded losses from FY 2001/02. For FY 2004/05, Denel recorded a loss of R1 604 million.

Liquidity and Solvency

Liquidity refers to a company's ability to repay maturing short-term debt. Whilst taking into consideration the nature of the business and the mix of components of assets and liabilities, a liquidity ratio greater than 1 is deemed acceptable. Solvency, on the other hand, indicates the company's ability to meet its long-term fixed expenses and to accomplish long-term expansion and growth. From the table below, Transnet and Denel's liquidity ratios for FY 2004/05 fell indicating that their current liabilities exceeded their current assets and that the company may experience difficulties repaying current liabilities in the short term without recourse to external financing.

R 'million	2001	2002	2003	2004	2005
arivia.kom					
- Liquidity ratio		1.3	1.5	1.4	1.6
Alexkor					
- Liquidity ratio	1.14	2.15	3.42	4.09	4.21
- Solvency ratio	0.98	1.00	1.03	1.29	1.25
Denel					
- Liquidity ratio	1.40	1.08	1.45	1.17	0.88
- Solvency ratio	0.98	1.00	1.03	1.29	1.25
Eskom					
- Liquidity ratio	1.07	1.37	1.09		1.22
- Solvency ratio	1.72	1.80	1.86		1.73
SAFCOL					
- Liquidity ratio	2.15	1.16	1.89	1.49	1.98
- Solvency ratio	2.83	2.93	3.83	3.53	3.89
Transnet					
- Liquidity ratio	0.83	1.34	0.75	0.51	0.70
- Solvency ratio	1.48	1.42	1.35	1.14	1.30

Denel and Alexkor's solvency ratios deteriorated in FY 2004/05, increasing the risk of technical insolvency.

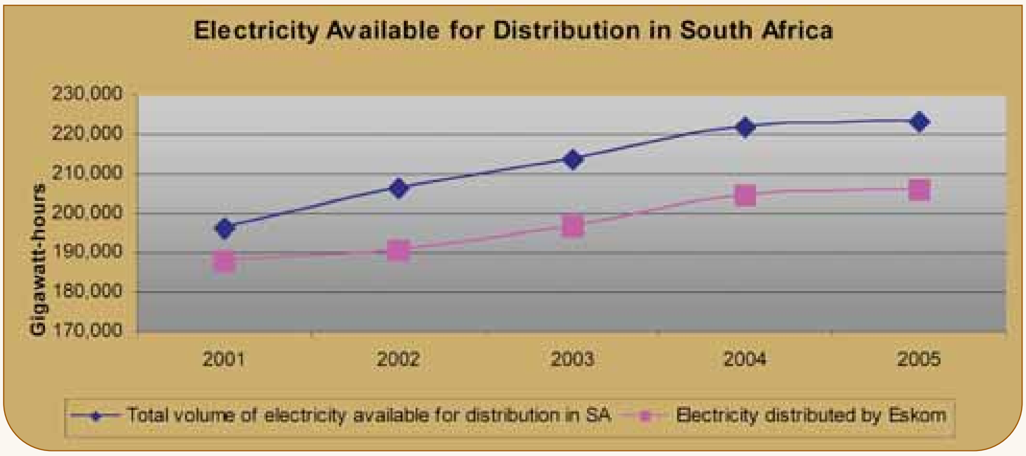


Eskom

Eskom

Eskom In Perspective

The Electricity sector in South Africa has entered a challenging phase starting from 2005. The challenge is posed by the fact that South Africa's surplus generation capacity has been steadily reducing due to substantial and sustained growth in the demand for electricity. Growth in elactricity demand is expected to continue over the next decade underpinned by growth in industrial, mining and commercial sectors. The National Intergrated Resource Plan (NIRP) estimates that about 2 640MW of new peaking generation capacity will be required between 2006 and 2010 based on an average annual economic growth rate of 2.8 percent. New base load capacity will have to be created after 2010.



Source: Stats SA

In order to address the new generation capacity requirements, Cabinet decided that Eskom would build 70 percent of the required new capacity while the Independent Power Producers (IPPs) would build the other 30 percent. Eskom plans to invest R84 626 billion over the next five years. Of this, R53 083 billion is earmarked for the Generation sector (this amount includes the new build and the return to service of moth-balled plants).

While the need for new investment is generally accepted, Eskom believes that there is an equally important objective, namely that of ensuring that the quantum, timing and mix of new investments are optimal in order to avoid unnecessary costs being imposed on electricity consumers.

Electricity Distribution Industry Restructuring is also proceeding, guided by a Cabinet decision to establish six Metro Regional Electricity Distributors (REDs) and one National RED. It is expected that Eskom will be the anchor of the National RED.

Performance

Eskom maintained its record of sustainable profitability, meeting bottom-line targets, except for 2003 where the profitability ratios were negatively affected by the significant impairment provisions for investments in Mountain Communication (MKC) in Lesotho and the Second Network Operator (SNO). It is important to note that Eskom's financial year-end changed from 31 December 2003 to 31 March 2005 resulting in a 15-month reporting period for this financial year thus affecting some year-on-year ratio analysis. Eskom also succeeded in recording continuous improvements in working capital management and capital structure in terms of external funding levels.

Eskom's contribution to sustainable development over the past 5 years includes the following:

- Electrification of an additional 222 314 households during FY 2004/05;
- Procurement from black owned enterprises totalling R27.6 billion over the five-year period. Approximately 60% of this amount is allocated to small and medium enterprises (SMMEs) owned by black people.
- The Electrification program estimated to have improved the living standards of over 14 million South Africans since 1994. According to figures published by the National Energy Regulator of South Africa (NERSA), is now 70% electrified. As at the end of 2002, 50% of rural households were electrified as compared to 12% in 1994.

Financial Performance

Eskom's financial performance[2] over the period of review is depicted in the following graph:

Turnover has shown a steady increase over the period of review, with revenue for the 15 month period ending 31 March 2005 amounting to R 42 984 million, compared with revenue for the 12 month period ending 31 December 2003 amounting to R 32 984 million. The annualised revenue for FY 2004/05 amounts to R 34 387 million[3].

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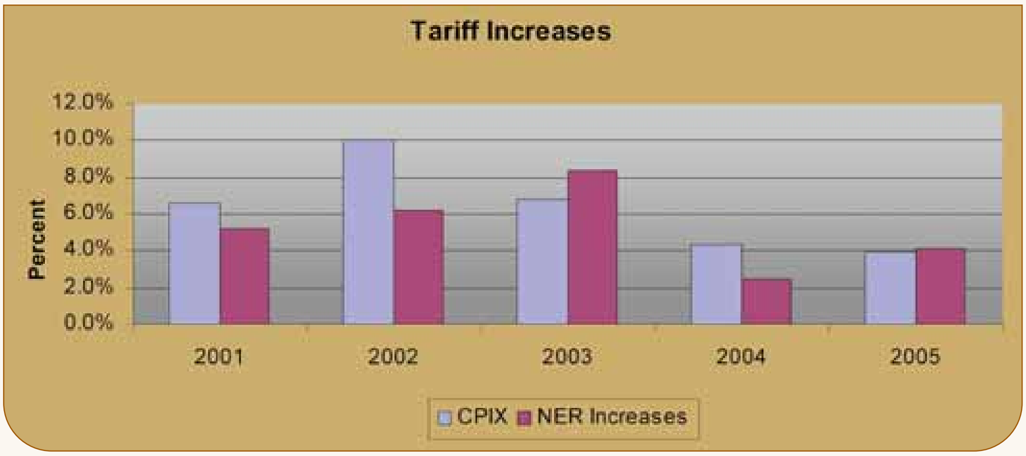
[2]The results for FY2005 represents a period of 15 months compared to the previous years of 12-month periods.
[3]The annualised revenue is determined on a straight-line method as Eskom's most profitable months are during the winter months. The winter months features in both periods.

This represents a 4% increase from FY 2003 (if FY 2004/05 represented a 12-month period).

Eskom's tariff increases are subject to annual approval by the National Energy Regulator. The following graph depicts the historical tariff increases compared to CPIX:



The above graph indicates that Eskom's tariff increases approved by the NERSA have historically been lower than CPIX[4] (except for FY 2003). The increase in revenue achieved over the period under review was therefore mainly due to increases in volumes produced and distributed. Government recently approved a structure for multi-year pricing determinations, as compared to historical single-year pricing method (similar to petrol price determination).

The following table depicts Eskom's profitability in terms of earnings before interest and tax profit margins for the period under review:

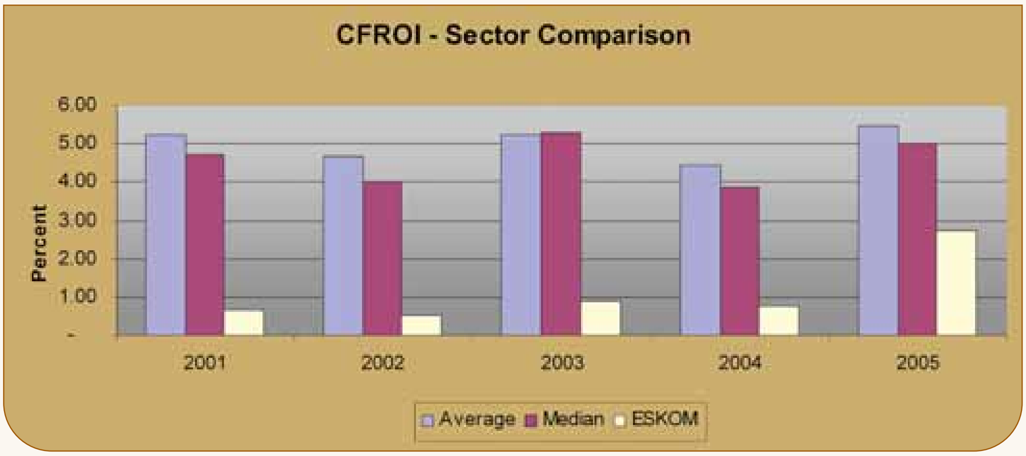
[4]Based on average annual Consumer Price Index (CPIX) and the average annual inflation rate for the historical metropolitan and other urban areas according to main indices

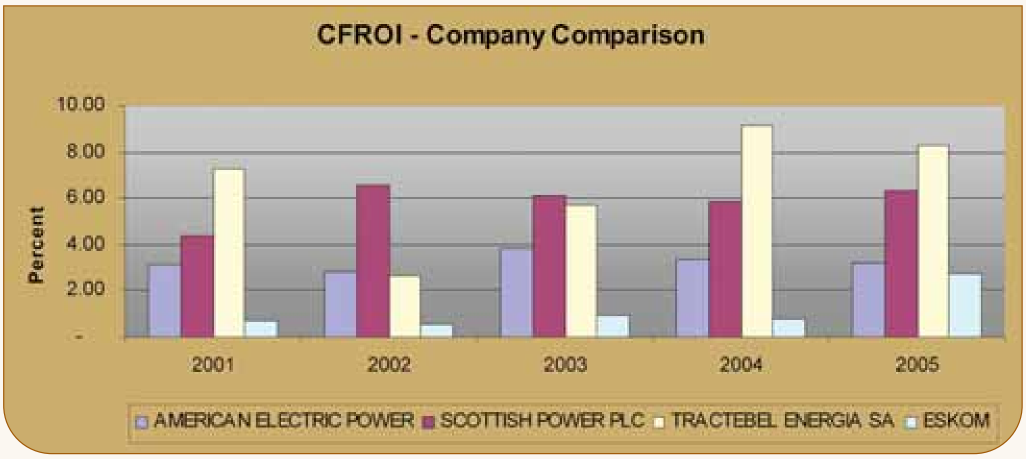
The decline in profitability ratios for FY 2003 was due to the significant impairment provisions for the investment in MKC Lesotho and the (through Eskom Enterprises as wholly owned subsidiary). The net impact of these provisions during FY 2003 amounted to R803 million. The operating margin for FY 2004/05 was also negatively impacted by the increased depreciation charges from additional investment in property, plant and equipment as well as additional costs relating to contracts.

The net profit after tax amounted to R 5 197 million during FY 2004/05 (FY 2003: R 3 417 million). Eskom's net profit after tax remained stable with net profit margins improving from 7% during FY 2000 to 12% during FY 2004/05 (FY 2003: 10%).

CFROI®

Eskom's CFROI has been compared to other international energy utilities in order to interpret the CFROI results better. The average and median of these companies are used as a measure to assess Eskom's performance, but not necessarily to benchmark performance, as depicted in the following graphs:



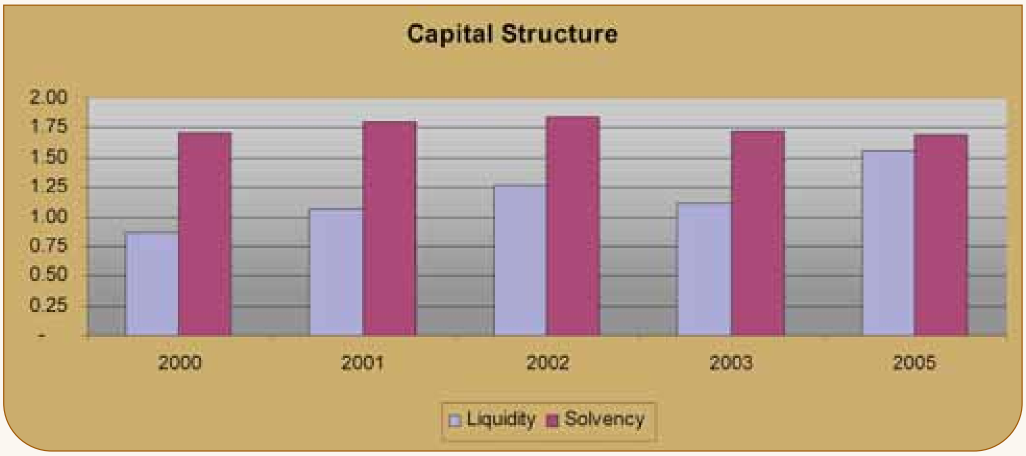


Eskom's CFROI was far below the average and median of other international energy utility companies, such as American Electric Power and Scottish Power PLC. However, Eskom did show improvement in this measure from 0.09% during FY 2000 to 2.75% during FY 2004/05.

The improvement was mainly due to the 15-month reporting period, as the CFROI model does not annualise the earnings against investments. It was expected that Eskom's CFROI would normalise from the 2005/06 financial year onwards, whereby year-on-year comparison will be simplified.

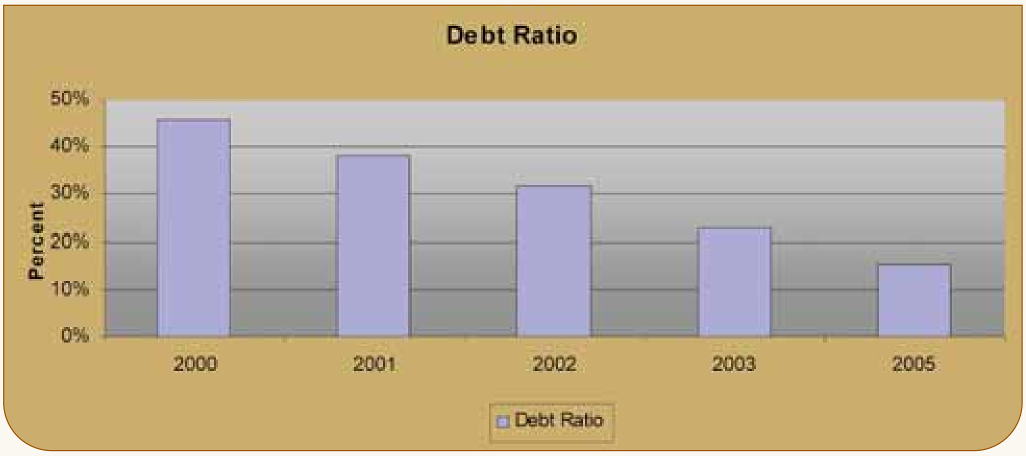
Financial Position

Eskom continued to improve its capital structure through sustainable profitability, with capital and reserves increasing from R40 683 million at the end of FY 2003 to R44 867 million at the end of FY 2004/05. The solvency and liquidity ratios improved during FY 2004/05, as depicted in the following graph:



The liquidity ratio improved from 1.11 times in FY 2003 to 1.55 times in FY 2004/05 (FY 2002: 1.27), although it remained below the theoretical benchmark of 2 times. The improvement was mainly due to the increase in short-term financial instruments such as negotiable securities.

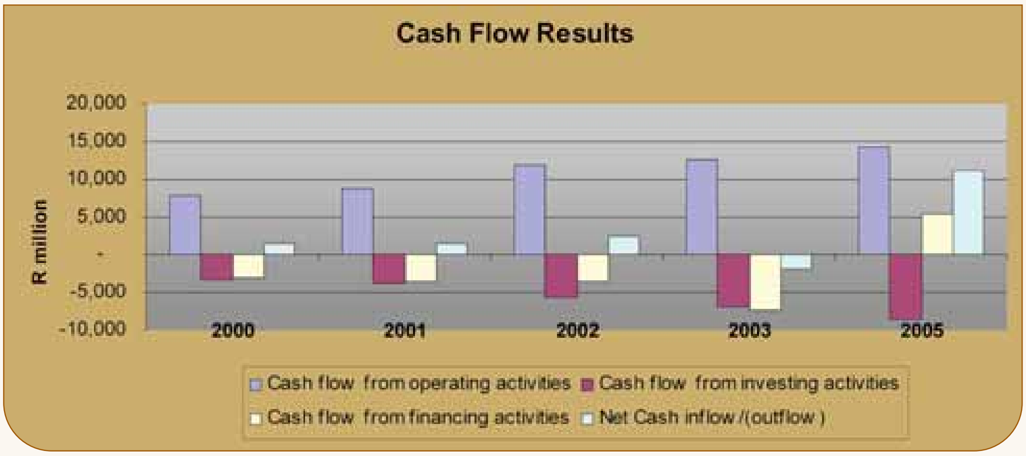
Eskom made concerted efforts to strengthen the balance sheet over the five-year period, resulting in a reduced debt ratio, as depicted in the following graph:



Even though long-term financial instruments increased by R4 547 million, the increase in short-term financial instruments (R7 836 million) and capital and reserves (R4 284 million) contributed to the reduction of the debt ratio from 23% in FY 2003 to 15% in FY 2004/05. The strong balance sheet will assist in reducing its cost of external funding which is crucial as the build programme gains momentum.

Cash Flow Results

The following depicts the cash flow results of Eskom over the period of review:



Cash flow from operating activities continued to improve year-on-year, with cash inflows increasing from R12 664 million during FY 2003 to R14 295 million during FY 2004/05 (FY 2002: R11 808 million).

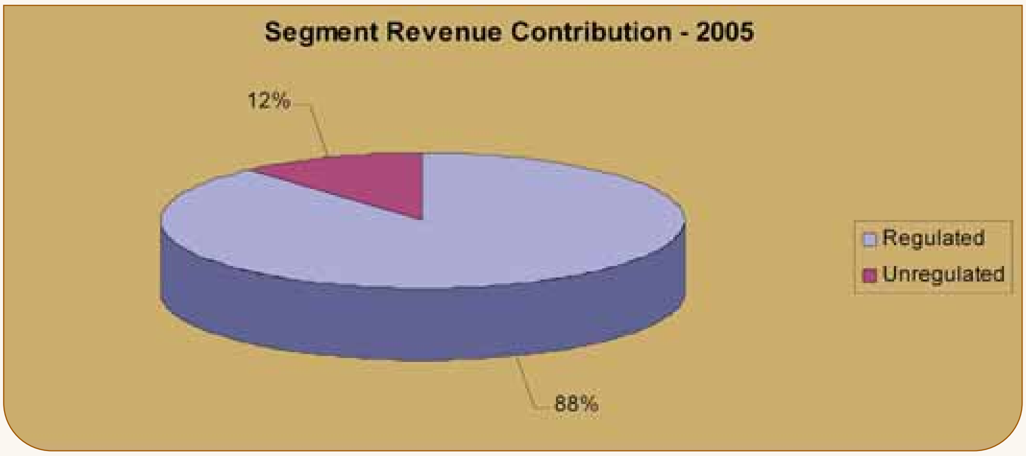
Expenditure on infrastructure investments increased by a nominal R2 401 million from FY 2003, totalling R8 642 million during FY 2004/05 (FY 2003: R 6 241 million).

However, the analysis of the cash flow results of FY 2004/05 indicates that Eskom was not required to source cash from investing activities, as sufficient cash was generated from operating activities to fund investments. The excess cash generated was held in commercial banks, negotiable securities and money market assets.

Performance Per Segment

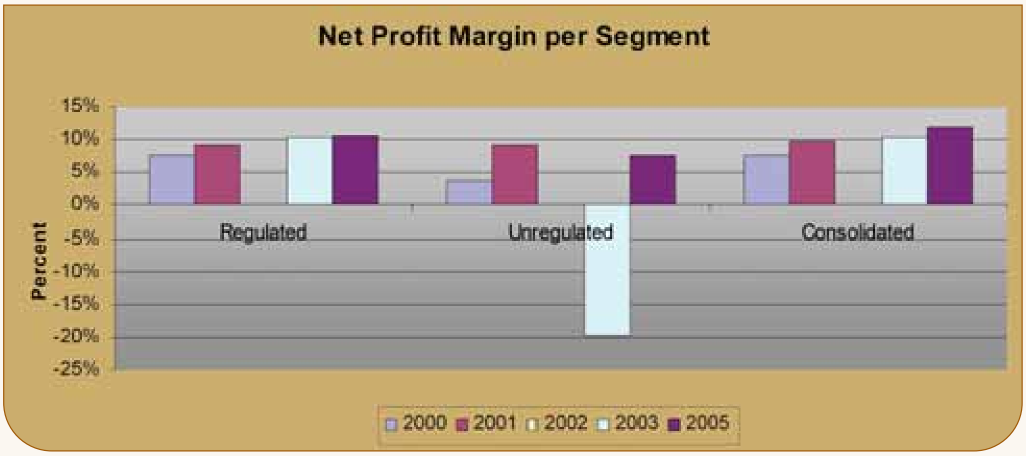
Eskom's performance is divided between the regulated and the non-regulated segments. Regulated services relate to the generation, distribution and transmission of electricity within the border of South Africa (regulated by the NERSA). The unregulated segment includes all other services.

The Regulated Segment is the major contributor to revenue in the Group, as depicted in the following graph:



The contribution levels did not change from FY 2003, with Regulated contributing 88% of revenue and Unregulated contributing 12%.

The following graph depicts the net profit after tax per segment and consolidated (as a percentage to compare the 15-month period to previous 12-month periods):

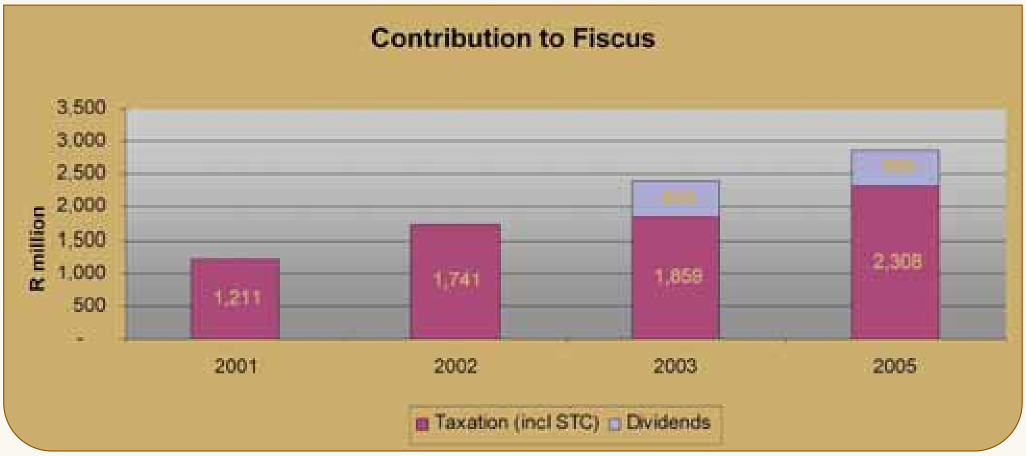


The Unregulated Segment returned to profitability, with net profit after tax amounting to R421 million in FY 2004/05, compared to the loss of R796 million during FY 2003, which was due to the significant impairment provisions for the investment in MKC Lesotho and the SNO.

The Regulated Segment continued to improve profitability marginally and achieved stable net profit margins over the period under review.

Contribution To Fiscus

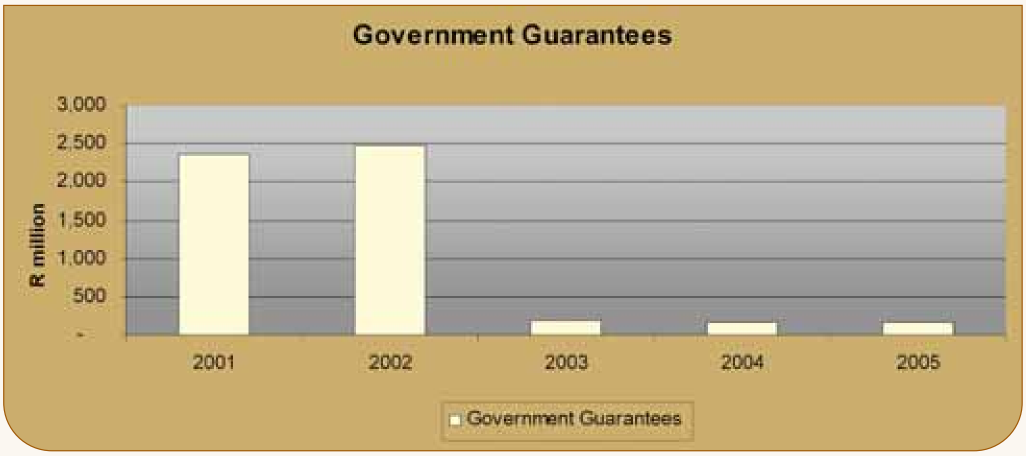
The following table depicts Eskom's contribution to the fiscus over the 5-year period through dividends paid to government as shareholder and tax[5] (including Secondary Tax on Companies).



A dividend of R1.6 billion was declared subsequent to FY 2004/05 and was paid to Government during July 2005.

Government Exposure

Government's direct exposure in terms of guarantees issued to Eskom is depicted by the following graph:



The improvements in the capital structure and debt ratio over the period of review resulted in less reliance on government to provide guarantees for Eskom's long-term debt. Government's exposure to Eskom's debt reduced from R2 367 million during FY 2000/01 to R156 million during FY 2004/05[6].

[5] As per Value Added Statements and includes the impact of deferred tax.

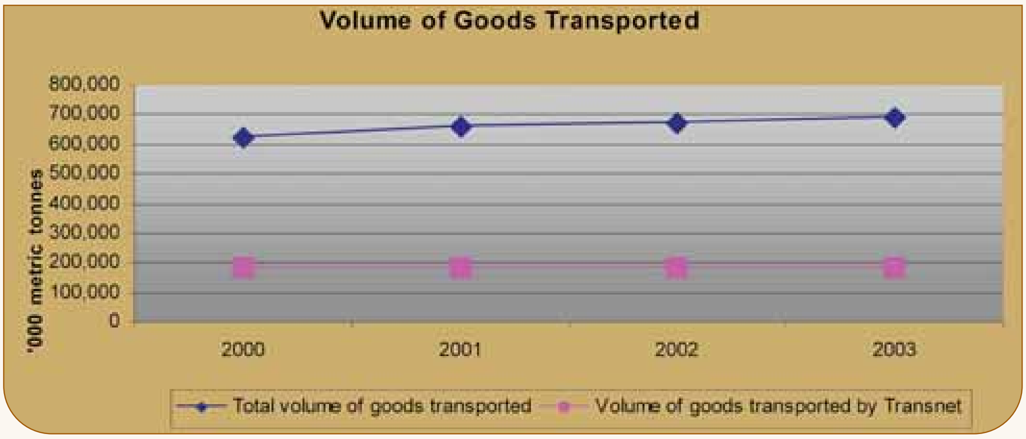
[6] The financial year-ends referred to in the paragraph relates to government's financial year-end – 31 March for the period under review.

Transnet

Transnet

Transnet In Perspective

The South African economy has been growing at a steady pace over the last five to ten years. Exports of bulk commodities as well as intermediate manufactures have increased significantly year on year. Unfortunately, the transport system, both from an infrastructure as well as operations perspective, has not kept pace with the growth in trade. In particular, lack of investment and performance in ports and rail freight (both monopoly sub-sectors in Transnet), have had a serious restraining consequence on further economic growth and industrial competitiveness. The poor performance in rail transport has unfortunately also paved the way for road transport operators to transport significant volumes of 'rail-friendly' cargo on South Africa's already strained road network, at a higher cost to importers, exporters, consumers and the taxpayer.



Source: Stats SA

The National Freight and Logistics Strategy (NFLS) proposed by the Department of Transport provides the necessary direction to Transnet and other transport role players to begin to address the myriad of challenges that the industry faces. A core element of the NFLS is the movement towards a more balanced transport industry structure i.e. less public monopoly services, more private operators in a competitive environment (leading to more efficient investments and service provision) and appropriate levels of regulation per transport sub-sector. Transnet's new strategy is generally aligned to the NFLS and successful implementation should thus ultimately result in Transnet making a substantial improvement of the transport system as a whole.

In light of the above, Transnet committed to contribute an estimated R40 billion to the transport system over the next five years commencing during the 2005/06 financial year. This figure has been adjusted to R64.5 billion, which includes a number of new projects to create capacity in future years as well as the impact of the strategy to address the backlog investment and capitalisation of some of Spoornet's maintenance expenditure. Progress against the above capital expenditure programme will be reported during subsequent publications.

Performance

It is apparent that the four-point turn around strategy, implemented during August 2004, affected the results of Transnet for FY 2004/05 positively. Two of the major value destroyers during FY 2003/04, the SAA hedge book and US-Dollar based Kumba iron ore contract, were resolved during the period under review. The hedge book was
closed and the iron ore contract re-negotiated to address the embedded derivatives.

The impact of the closure of the SAA hedge book on the Group results can be seen in the cash outflow of approximately R6 billion. As the hedge book was closed during the first quarter of FY 2004/05, no further material fair value adjustments in this regard were reported.

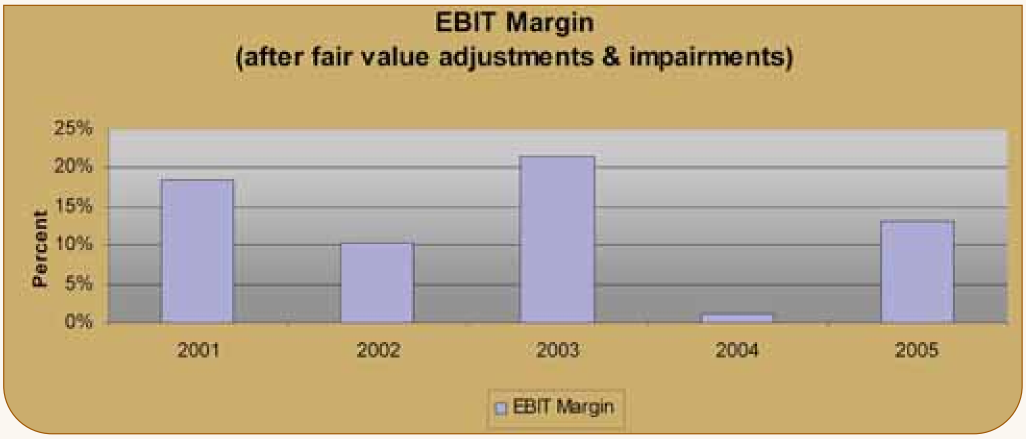
Financial Performance

Transnet's financial performance over the period of review is depicted in the following graph:

Turnover showed a steady increase over the period of review, from R43 637 million recorded during FY 2003/04 to R46 259 million during FY 2004/05 (a nominal increase of 6%). The operating profit margin[7] increased from 10.1% during FY 2003/04 to 12.9% during FY 2004/05 (FY 2002/03: 12.3%), EBIT was R5 971 million (FY 2003/04: R4 408 million).

[7]Before impairments, as the impairments do not impact the actual operational performance.

The following table depicts Transnet's profitability in terms of earnings before interest and tax profit margins for the period under review:

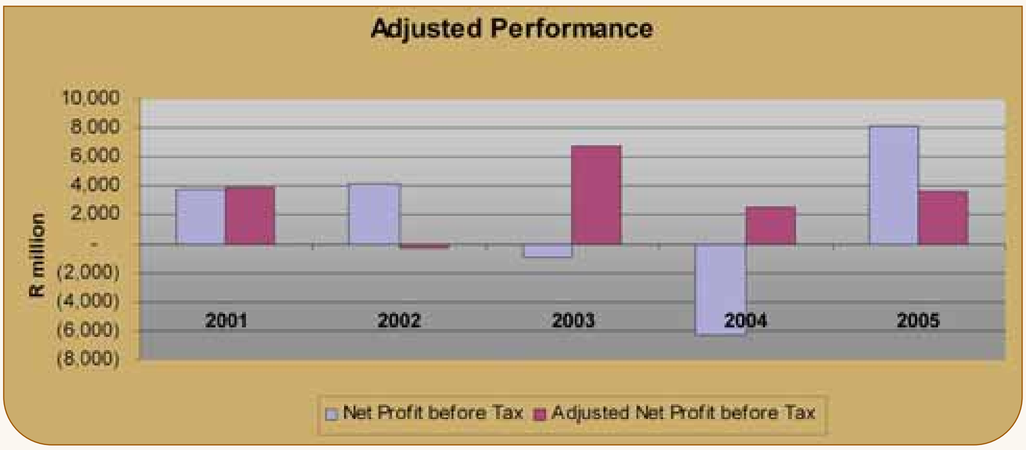


The material difference between the operating profit margin and EBIT margins is mainly due to the negative effect of impairments of assets and fair value adjustments. The impairment of assets amounted to R4 221 million during FY 2003/04, resulting from the revaluation of aircrafts. This negative impact was not repeated during FY 2004/05.

Also, the negative fair value adjustments during FY 2002/03 (R7 184 million) and FY 2003/04 (R6 364 million), relating to embedded derivatives were not repeated during FY 2004/05. The following factors affected the fair value adjustments accounted for during FY 2004/05:

- The SAA hedge book was closed during the 1st quarter of FY 2004/05;
- During FY 2003/04, Transnet recognised a liability of R4 529 million for embedded derivatives arising on two major iron-ore contracts. Transnet renegotiated one of the contracts from a US Dollar base to Rand base, resulting in the reversal of the previous year's embedded derivatives.

As a result, profit before tax increased materially from a net loss of R6 211 million during FY 2003/04 to a net profit of R8 156 million during FY 2004/05. To interpret Transnet's real performance, the material once-off items were removed from the financial performance, and are depicted in the following graph:

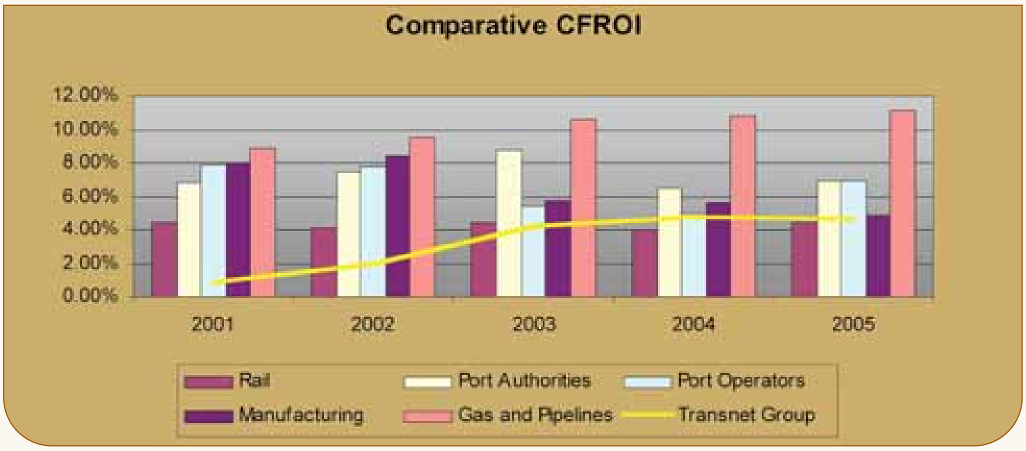


The above graph indicates the impact of fair value adjustments and impairment of assets on Transnet results. The adjusted performance trend agrees in all material respects to the gross operating profit margin movements and stable finance costs. There has been an improvement of 40% in adjusted financial performance from FY 2003/04.

In FY 2002/03, 2003/04 and 2004/05, the derivatives and embedded derivatives clouded the actual performance of Transnet. The FY 2004/05 adjusted performance is therefore lower compared to the reported results, but still showed improvement from FY 2003/04.

CFROI®

Transnet's CFROI has been compared to other international ports, rail, pipeline and transport manufacturing companies in order to interpret the CFROI results better. The median CFROI of these companies are used as a measure to assess Transnet's performance, but not necessarily to benchmark performance, as depicted in the following graphs:



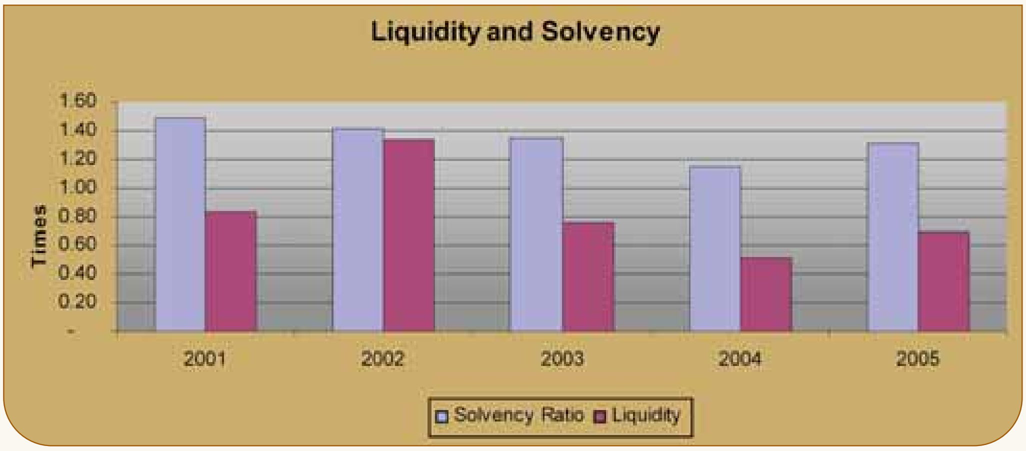
As Transnet's business and company structure is unique to South Africa, it was not possible to compare Transnet's CFROI with similar companies. The CFROI comparison is limited to a comparison to sectors, made up of individual international companies.

Transnet's CFROI improved from 0.88% during FY 2000/01 to 4.62% during FY 2004/05, indicating improved cash returns over assets employed, even though the assets (with specific reference to Spoornet) are aged and in need of replacement. The CFROI calculation is however a true reflection of the performance of the assets.

However, it is important to note that as a major portion of the investments are in assets with a long life span and payback period, the huge investment has a negative impact on cash over the short term. For example, Transnet has invested in Coega (Port of Ngqura) more than R3bn without any returns reflected to date. This must also be viewed in the context that tariff increases (notwithstanding the huge investment) have been kept to below inflation.

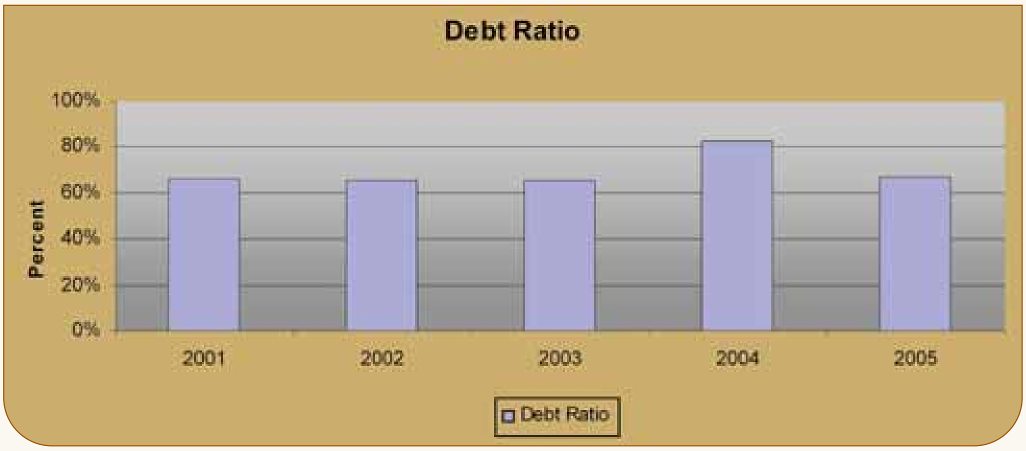
Financial Position

The capital structure of the group also improved dramatically during the period under review, as depicted in the following graph:



The solvency ratio improved from 1.14 during FY 2003/04 to 1.30 during FY 2004/05 (FY 2002/03: 1.35). The improvement achieved during FY 2004/05 was the first improvement in the capital structure since FY 2000/01, indicating the effectiveness of the turnaround strategy. The liquidity ratio also improved from 0.51 during FY 2003/04 to 0.70 during FY 2004/05 (FY 2002/03: 0.75). The liquidity ratio is below the peers, which vary between 0.9 times to 1.3 times. However, given Transnet's financial strength, the liquidity portion was not negatively impacting on the growing concern status of the company. The relatively low ratio indicates that Transnet was using cheaper short term funding services to fund operational requirements.

Transnet made a concerted effort to improve the debt ratio[8] from FY 2003/04, as depicted in the following graph:



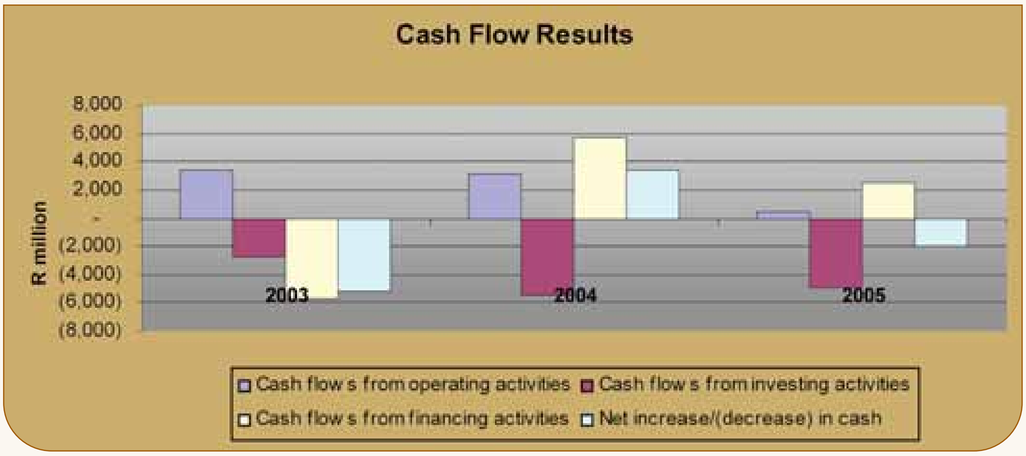
The debt ratio improved from 83% at FY 2003/04 to 67% at FY 2004/05, which compares favourably to the average of between 60% and 70% during the previous years before FY 2003/04. However, debt ratio was still below the target debt ratio of 50%. Transnet's debt ratio would improve to 55% if SAA were excluded from the balance sheet.

[8] Transnet's debt ratio is calculated by dividing the sum net financial instruments (short-term and long-term) and provisions by total funds.

Although the above improvements were substantial, the capital structure of Transnet remained a point of concern in terms of financial risks relating to pension fund liabilities, affordability of debt and the availability of future funding from outside financial providers without relying on government guarantees.

Cash Flow

The following graph depicts the cash flow results of the group:

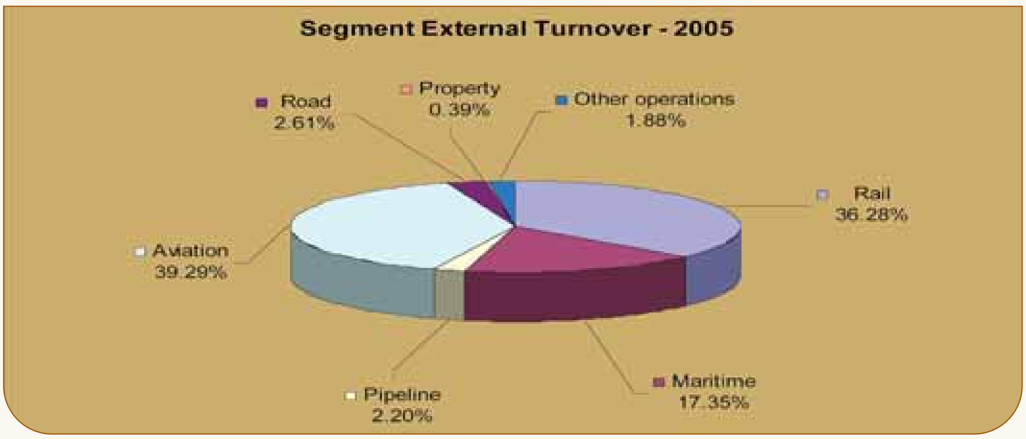


The material decrease in cash flow from operating activities declined from R3 113 million during FY 2003/04 to R484 million during FY 2004/05 due to the cash effects of settling SAA's hedge book liabilities (approximately R6 billion). The normal operational cash flow (as part of total cash flow operating activities) improved from R4 952 million during FY 2003/04 to R7 536 million during FY 2004/05, although not enough to offset the cash effect of settling SAA's hedge book.

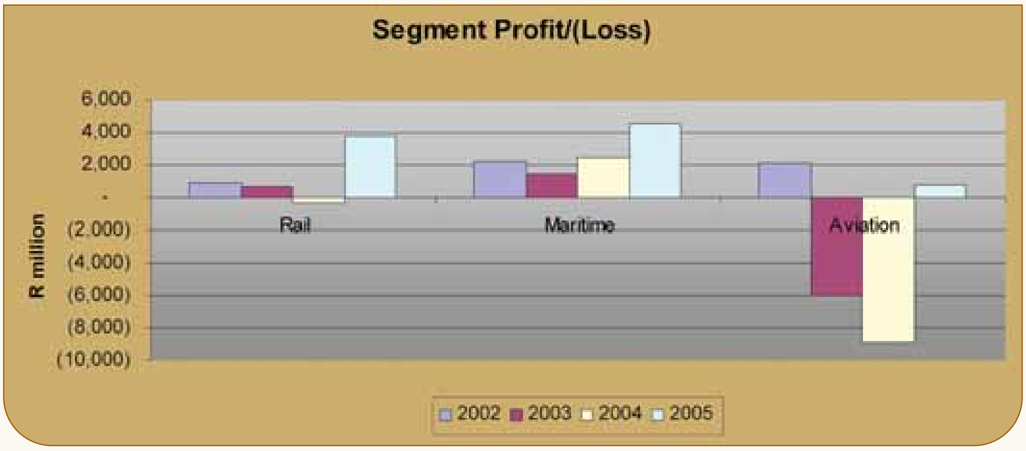
The settlement of SAA's hedge book ultimately affected the net decrease in cash and equivalents amounting to a net cash outflow of R2 017 million during FY 2004/05, compared to a net increase in cash and cash equivalents of R3 341 million during FY 2003/04.

Performance Per Segment

The performance of the group was directly affected by the contribution and profitability of each segment (major business units). The following pie chart discloses the revenue mix to external clients for FY 2004/05, which has been consistent since 2001:



Aviation, Maritime and Rail remain the main revenue contributors to the performance of the group as a whole. The financial performance of these segments are depicted in the following graph:

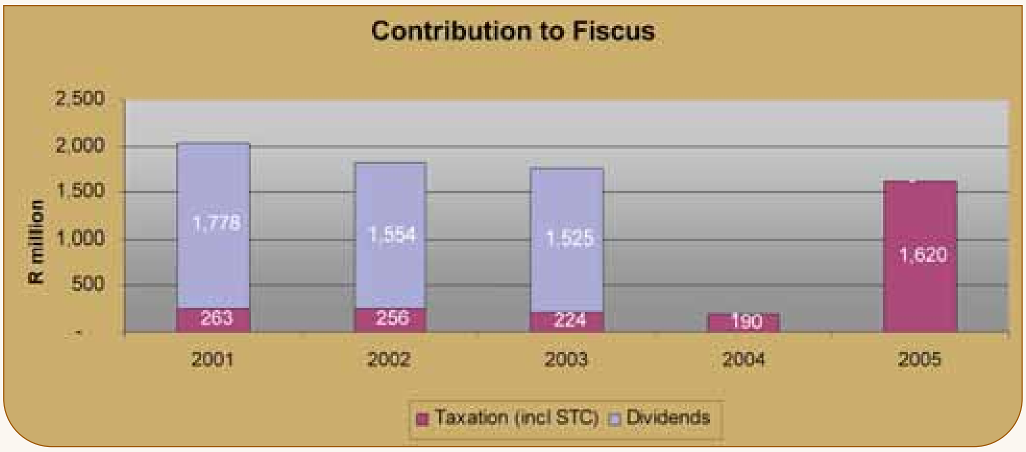


As one of the major contributors to the group in terms of turnover, Rail's (Spoornet) operating profit remained very low. Rail would have reported a loss before tax of R21 million in FY 2004/05 (FY 2003/04: R220 million loss) had it not been for the iron ore derivative income. The Return on Average Assets still remained negative at 0.2% (albeit an improvement from FY 2003/04 at negative 2.4%).

All the segments showed major improvements in financial performance from FY 2003/04. The Aviation sector (SAA) returned to positive operating margins, although insufficient to cover previous years losses. International competition and low cost carriers in the domestic markets remained a challenge for SAA, compounded by global events such as the 9/11, SARS virus and Middle East conflicts. With the hedge book resolved, and no future losses arising from this are expected.

Contribution To Fiscus

The following table depicts Transnet's contribution to the fiscus over the 5-year period through dividends paid to government as shareholder and normal tax[9] (including Secondary Tax on Companies).

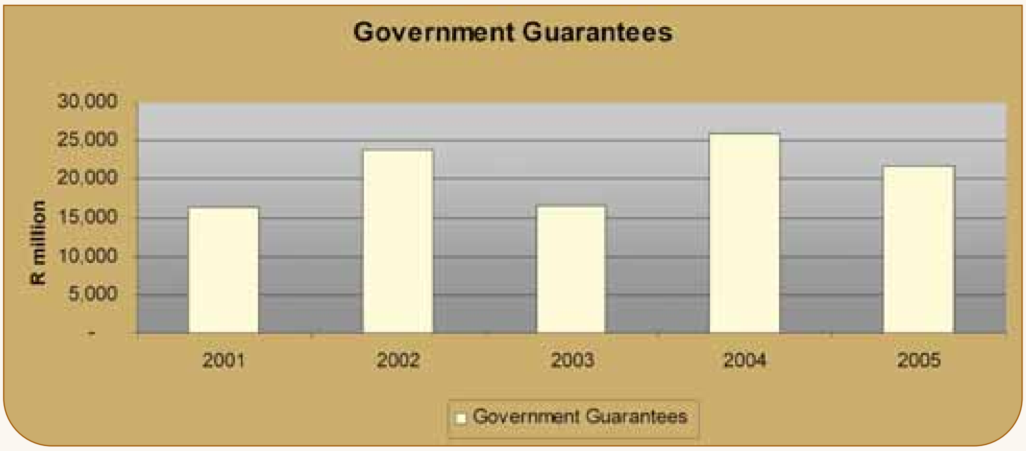


[9]As per Value Added Statements

No dividends were declared from FY 2003/04. A restructuring dividend of R1 525 million was declared during FY 2002/03, whilst normal dividends of R1 554 million and R1 778 million were declared during FY 2001/02 and FY 2000/01 respectively. As agreed with the Shareholder, Transnet is not expected to pay future dividends in view of its huge capital programme to improve service and to create capacity for future growth.

Government Exposure

Government's direct exposure in terms of guarantees issued to Transnet is depicted in the following graph:



Government provided R7 000 million in guarantees to Transnet in order to address SAA's financial position during FY 2003/04 arising from the impact of the hedge book. Guarantees issued to Transnet reduced from R25 975 million to R21 619 million as at FY 2004/05, which was mainly due to the closure of the Coupon Stock (Funding and Trading) facilities as well as SAA's funding requirements reducing from R7 000 million to R6 000 million as a result of the closure of the hedge book.

Denel

Denel

Denel In Perspective

Denel, formed in 1992, incorporating the manufacturing and industrial departments of Armscor. The South African defence budget reduced significantly from R11 billion in 1985 to around R4 billion during the early 2000's. Defence-spend then increased to around R7 billion in 2005. The bulk of this expenditure was for the strategic defence packages and was directed at meeting national security requirements through the acquisition of large and complex defence systems such as Corvette patrol boats. Since the local defence industry was not in a position to supply these systems, the increase in defence spend over the last 5 years was mainly directed at imports.

Denel therefore has not had a consistently captive market in terms of domestic defence spend. Although Denel has built up key manufacturing capabilities, the Group did not have the domestic scale to succeed as a viable independent systems developer. To increase revenue, Denel targeted the export market. It further diversified into non-core business opportunities, which proved unsuccessful, costing Denel in the region of R1 billion.

The drive to improve revenue through exports, however, resulted in an unfocused conglomerate. 60% of Denel's turnover of R4 billion is derived from 100 different products, which are exported to 60 different countries. Although there was mixed success in terms of exports, the lack of a clear strategy for global supply chain integration and the overhead cost has proved that this position is unsustainable, with Group net profits declining from R378 million in 1996 to a net loss of R1 604 million in 2005. The accumulated losses over the past four years effectively depleted Denel's capital structure to a negative R770 million (as at 31 March 2005).

Based on global and local defence industry trends, Denel is pursuing a strategy to consolidate its business and increase market share. The strategy is based on being a system supplier in the domestic market in Denel's area of competence and the domestic supply and export of niche sub-systems and components. Denel's success will be achieved through the formation of equity and business alliances with leading players in the defence industry, both domestically and internationally. Denel plans to consolidate its businesses and fragmented manufacturing facilities into three high-technology clusters.

Performance

The Group's net loss for FY 2004/05 amounted to R1 601 million, and this is significantly worse than the loss for FY 2003/04 at R378 million. The major contributors to the loss were mainly failure to achieve sales targets; the negative impact of exchange rate movements and the provision raised for future Rooivalk contract losses.

The continued loss-making activities resulted in a deteriorated financial position, with negative capital reserves amounting to R770 million for FY 2004/05. This resulted in serious growing concern problems for Denel and government provided guarantees to Denel amounting to R1 515 million, in order for Denel to continue its operations during FY 2005/06.

Financial Performance

The graph below depicts the financial performance of Denel for the past five years:

Denel achieved revenue growth through to FY 2003/04, with revenues increasing from R3 621 million in FY 2000/01 to R4 442 million in nominal terms in FY 2003/04, after which revenue declined to R3 784 million in FY 2004/05. The shortfall in revenue for FY 2004/05 can be attributed to Denel's failure to reach their sales targets as well as the impact of the stronger Rand on export sales.

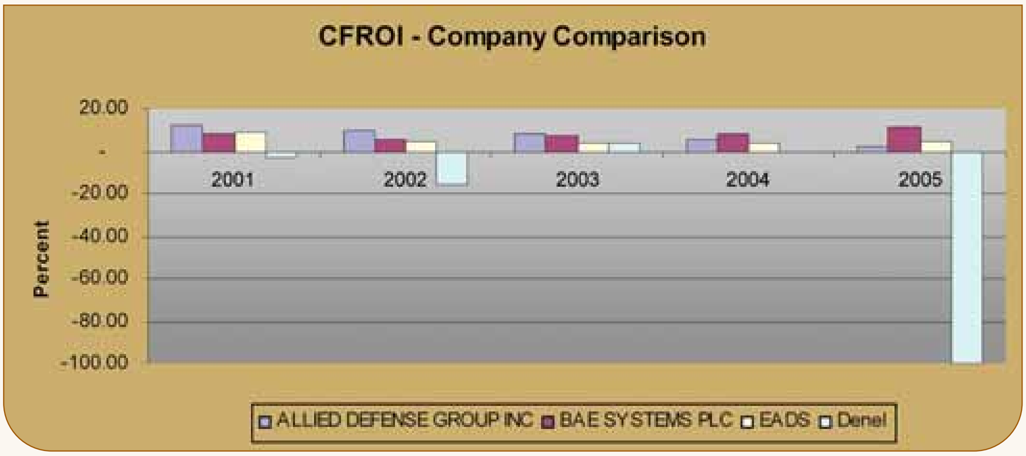
As reflected in the previous graph, there was no clear trend for operating profit over the past five years with spikes and dips over the five-year period. The significant operating loss for FY 2004/05 was mainly as a result of the sharp decline in revenue for FY 2004/05 of R658 million (considering Denel's high-fixed cost structure) and the increase of R702 million in the provision for contract losses, and the increase of R148 million in the impairment for property, plant and equipment.

The increase in the contract losses was a direct result of the FY 2004/05 risk provision of R680 million representing the expected loss on the Rooivalk project. During that year, the outstanding work was analysed in detail and the costs to complete the programme computed from a zero base. Due to practicalities, the provision was made in FY 2004/05 and was not adjusted retrospectively.

Denel posted a net loss for the year of R1 604 million for the FY 2004/05, which is R1 226.9 million more than the loss of R377.5 million posted for the FY 2003/04. The loss for FY 2002/03 was R72.6 million and while it was R363.2 million for FY 2001/02. The only profit recorded over the past five financial years was R24 million achieved in FY 2000/01.

CFROI®

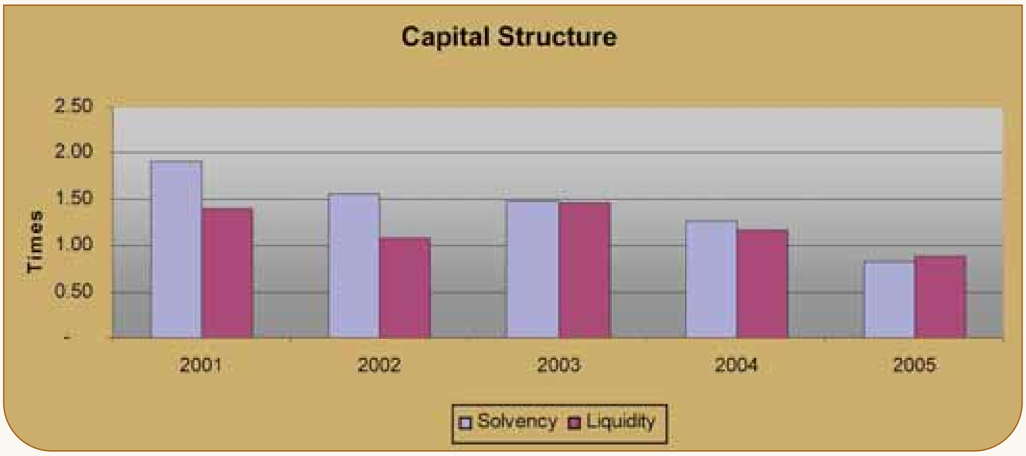
Cash flow return on investment is used as a measure of the true economic performance of a company. The essence of CFROI® is to look at cash-in versus cash-out, much as in a capital budgeting analysis. Denel's CFROI® has also been compared to other international defence and aerospace companies in order to interpret the CFROI® results better. The average and median of these companies are used as a measure to assess Denel's performance, but not necessarily to benchmark performance, as depicted in the following graphs:



The above graphs indicate that Denel has, in general, achieved negative CFROI® results, with CFROI® in excess of minus 100% returns during FY 2004/05. The average and median results of similar defence and aerospace companies, such as EADS and BAE systems, indicate that Denel was achieving far lesser results than industry peers. However, it should be noted that the defence industry in South Africa differs materially from the defence industries in countries such as the United Stated and Europe in general.

Financial Position

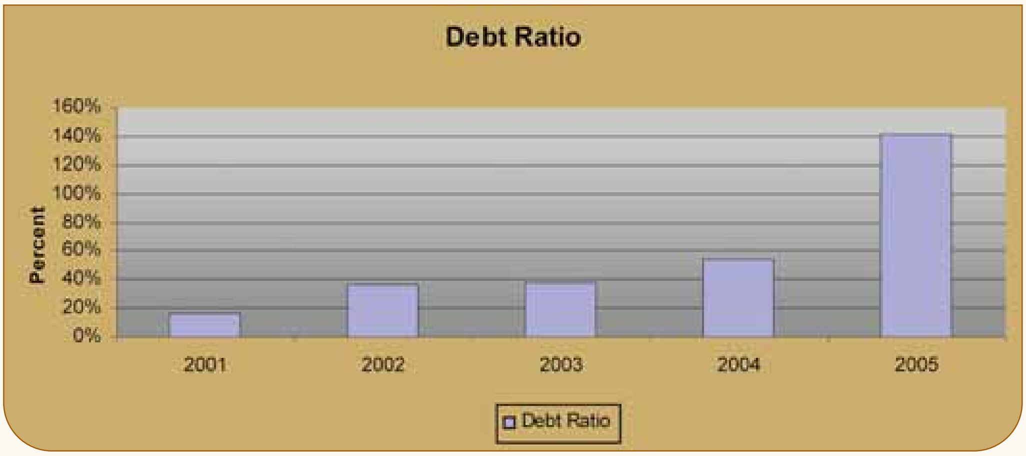
Due to the continued losses suffered by Denel over the four years to FY 2004/05, Denel's capital and reserves were eroded to a deficit of R770 million compared to a surplus of R1 760.8 million in the FY 2000/01. The graph below depicts the decline in solvency and liquidity from FY 2000/01 as a result of the recurring losses.



The liquidity ratio deteriorated from 1.4 in FY 2001 to 0.88 in FY 2005, indicating that Denel's current liabilities exceeded its current assets and would not be able to settle short-term debt with working capital. This fact was evidenced with Denel experiencing serious liquidity problems subsequent to 31 March 2005.

The solvency ratio is determined by comparing the total assets of the company to the total liabilities, and provides an indication of the longer-term stability of the company. The closer to 1 the solvency ratio moves, the lower the capital and reserves and the higher the risk going concern problems. The solvency ratio for FY 2000/01 was 1.89 dropping to 1.54 for the FY 2001/02, with a further drop to 1.48 in FY 2002/03. In FY 2003/04 the ratio was at 1.26. The solvency ratio for FY 2005 fell below 1 at 0.88.

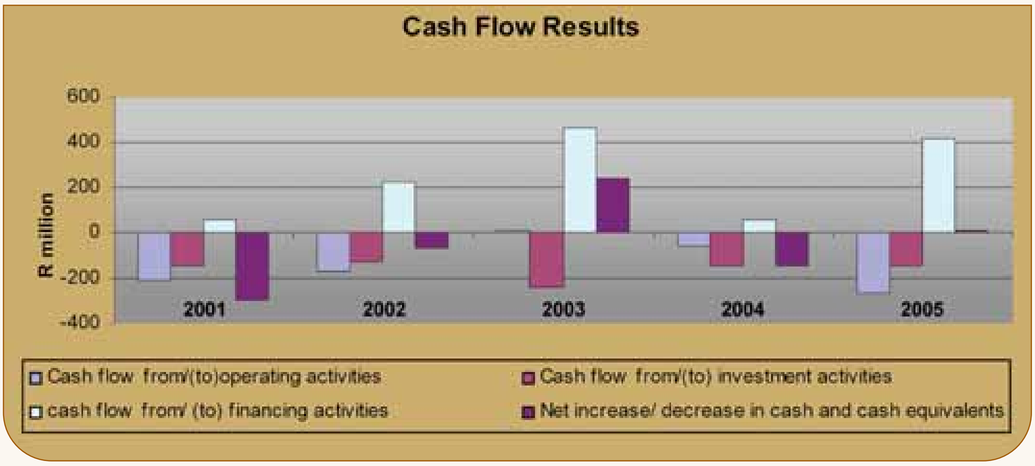
The debt ratio was also materially affected by the continued loss-making activities, as illustrated in the following graph:



The debt ratio deteriorated from a mere 16% during FY 2000/01 to 141% during FY 2004/05, due to the negative net asset position of Denel at the end of FY 2004/05.

Cash Flow Results

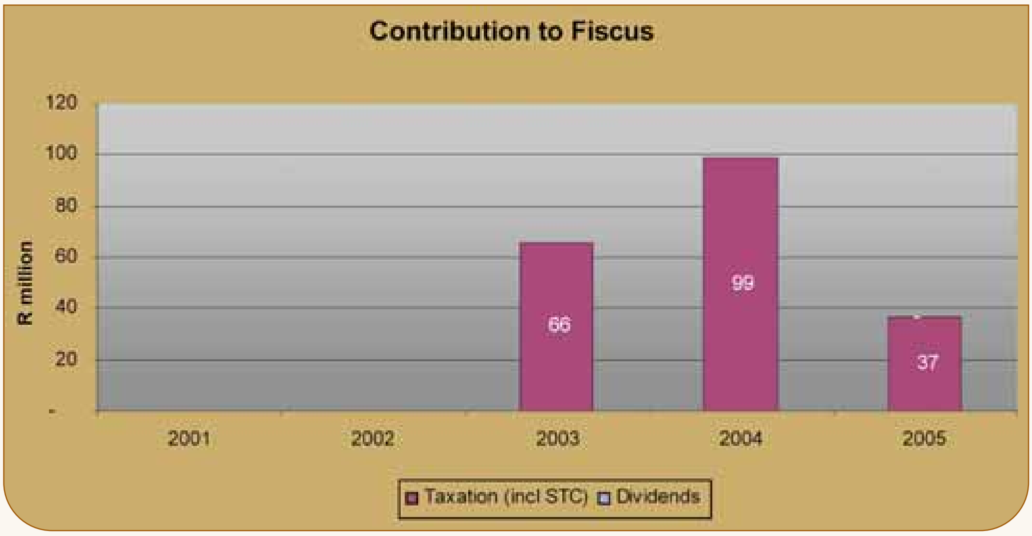
The graph below depicts the cash flow results of the group for the five-year period.



The group has mainly been generating negative cash flows from operating activities over the period. Normally, cash flow from operating activities funds a portion of the investing activities, to limit the reliance on financing activities. However, Denel was unable to fund investing activities from operating activities due to the continued operating losses. This compounded Denel's reliance on long-term funding to fund both operating and investing activities as can be seen in cash inflow from financing activities.

Contribution To Fiscus

The following table depicts Denel's contribution to the fiscus over the 5-year period through dividends paid to government as shareholder and normal tax[10] (including Secondary Tax on Companies):

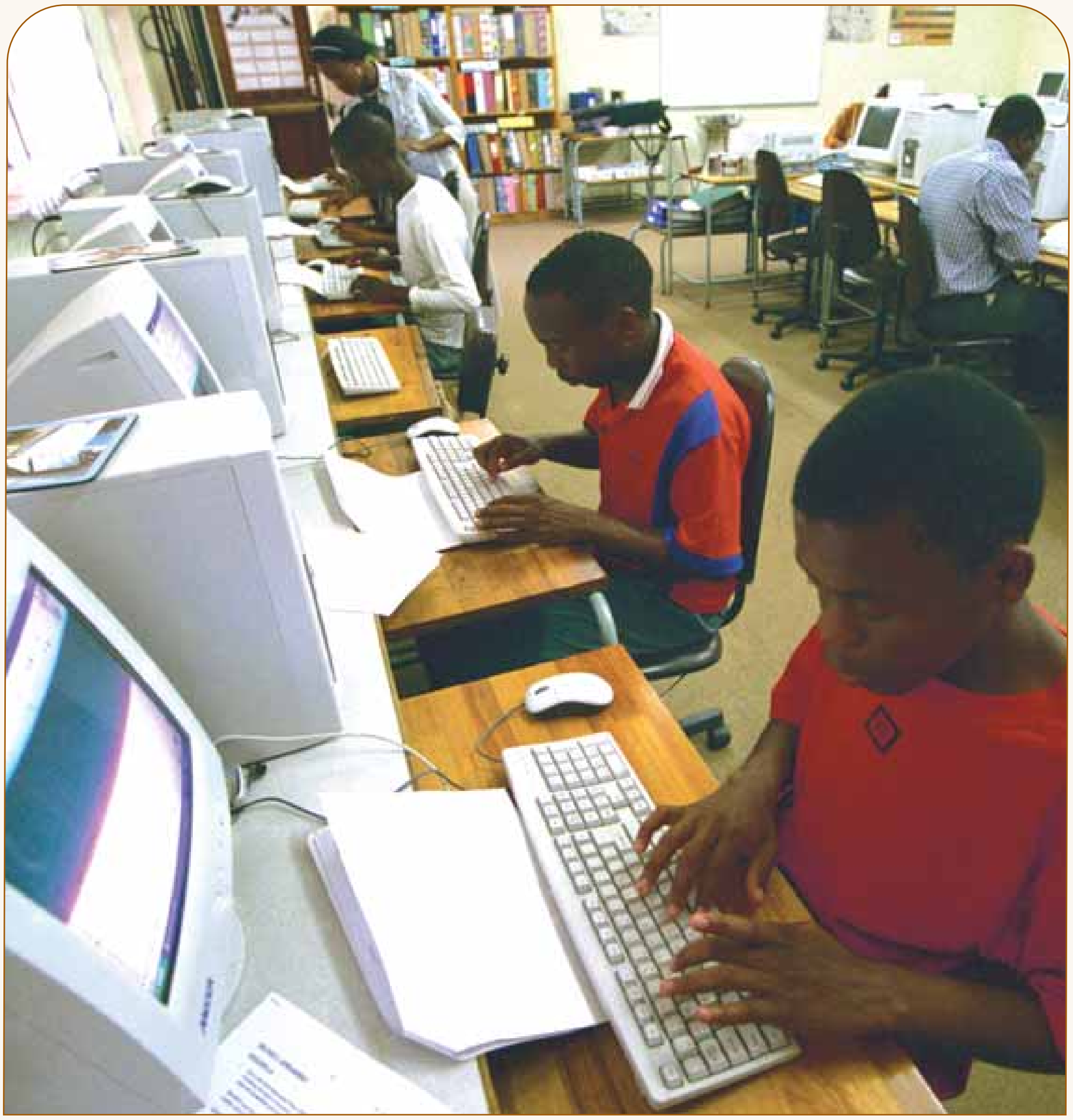


Denel has not been in a position to pay dividends since 1997.

Government Guarantees

No Government guarantees were issued for Denel as at 31 March 2005. However, in support of Denel's financial crisis, Government provided guarantees amounting to R 1 515 million to Denel subsequent to FY 2004/05.

[10] As per Value Added Statements



arivia.kom

arivia.kom

arivia.kom In Perspective

arivia.kom, jointly owned by Eskom and Transnet is a leading South African IT company operating throughout Africa, with the proven ability to implement customised, integrated IT solutions and provide services at whichever global location its clients may specify. Their end-to-end services and solutions generate significant business advantages for their clients. They have a thorough understanding of the market sectors in which they focus and an impressive track record as proof of their capabilities.

Performance

The overall financial performance of arivia.kom for FY 2004/05 declined when compared to previous years. Revenue decreased by 8% to R1 594.2 million in FY 2004/05 from R1 728.2 million in FY 2003/04, the first decrease since the inception of the company, which had shown a steady increase in revenue from FY 2001/02 through to FY 2003/04. The decrease in revenue can be attributed to a highly competitive IT market, lower sales to the private sector than budgeted, the longer lead times in Africa than budgeted and the effect of the cost cutting exercise at Transnet.

arivia.kom posted a consolidated net profit of R63.4 million for FY 2004/05, which compares favourably with R55.6 million recorded for FY 2003/04. This improvement is partly due to the utilisation of tax savings and a once off credit of R27.3 million related to the reversal of provisions.

The Group shareholders equity showed a steady improvement from R336 million in FY 2001/02 growing to R522 million in FY 2004/05 (prior year: R456 million). The Debt / equity ratio improved from 20% in FY 2003/04 to 14 % in FY 2004/05 while the debt ratio was 33% and 20% for FY 2003/04 and FY 2004/05 respectively. This improvement indicates a capacity to fund more activities through borrowings if the need rises without affecting the capital structure negatively.

Financial Performance

The graph below depicts the financial performance of arivia.kom over the period under review:

Net profit shows some fluctuation over the period increasing from R34.7 million in FY 2001/02 to R65.0 million in FY 2002/03 then decreasing to R55.6 million in FY 2003/04. In FY 2004/05 increased with 14 % to R63.4 million, partly benefiting from the utilisation of tax savings and a once off credit of R27.3 million related to the reversal of provisions.

The Group's operating profit margin for FY 2004/05 was not materially affected by the decrease in revenue from the FY 2003/04 figures, as it was off set by a decrease in salaries and wages. The following table depicts arivia.kom's profitability in terms of earnings before interest and tax profit margins for the period under review:

Net provisions related to FY 2003/04, were reversed to the income statement during FY 2004/05. This relates to the decrease in provisions for the legacy leave benefits, gratuity provisions and the Post Retirement Benefits, which resulted from the buy-out of these benefits by the employees. This revenue is non-recurring, and should it be eliminated the income before tax would have been R57.3 million, as compared to the disclosed R84.6 million.

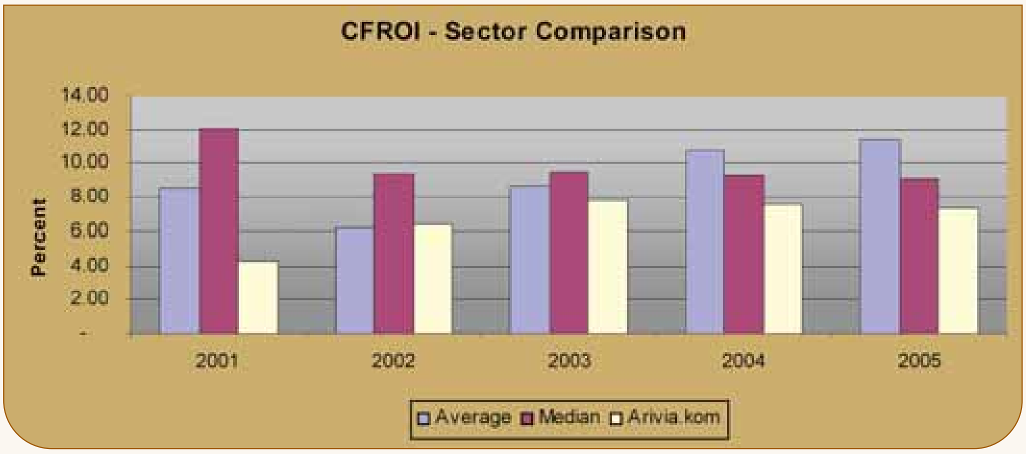
The net profit margin followed a similar trend, increasing from 2% in FY 2001/02 to 4% in FY 2002/03, dropping to 3% in FY 2003/04 and then recovering to 4% in FY 2004/05. The net profit margin remained very low.

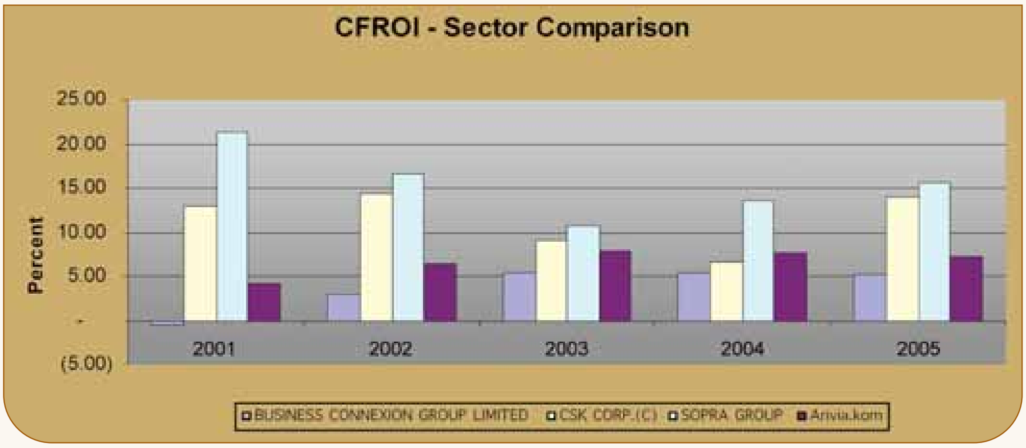
CFROI®

The recent CSFB Holt analysis performed on the 2003/4 results revealed the following:

- arivia.kom achieved operating margins above those attained by its peers in the industry.
- Despite good margins, arivia.kom's CFROI®'s were below the peer averages in the first two years of its operation.
- The Company's asset utilisation was below industry peers. The company seems to have invested in more assets than other companies in the same industry

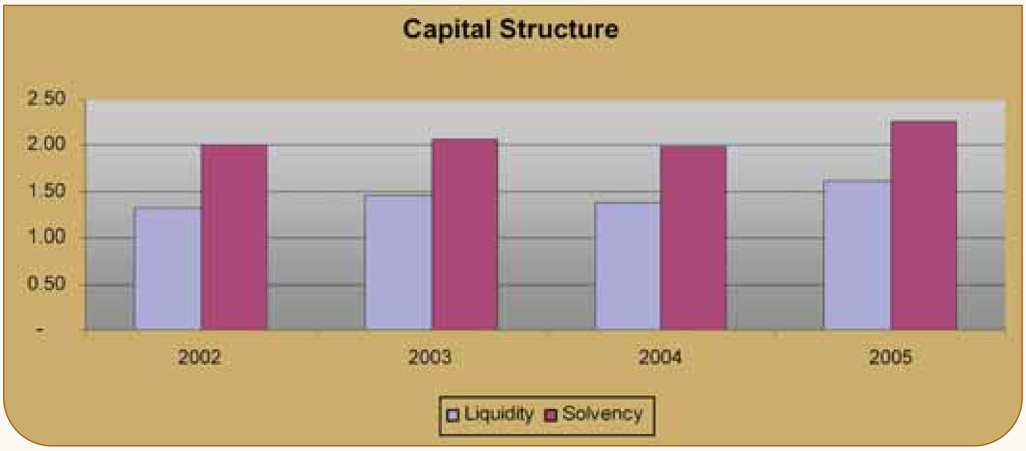
arivia.kom's financial results for the FY 2004/05 confirmed the above findings, as evidenced in the graphs below in comparison with similar IT companies:





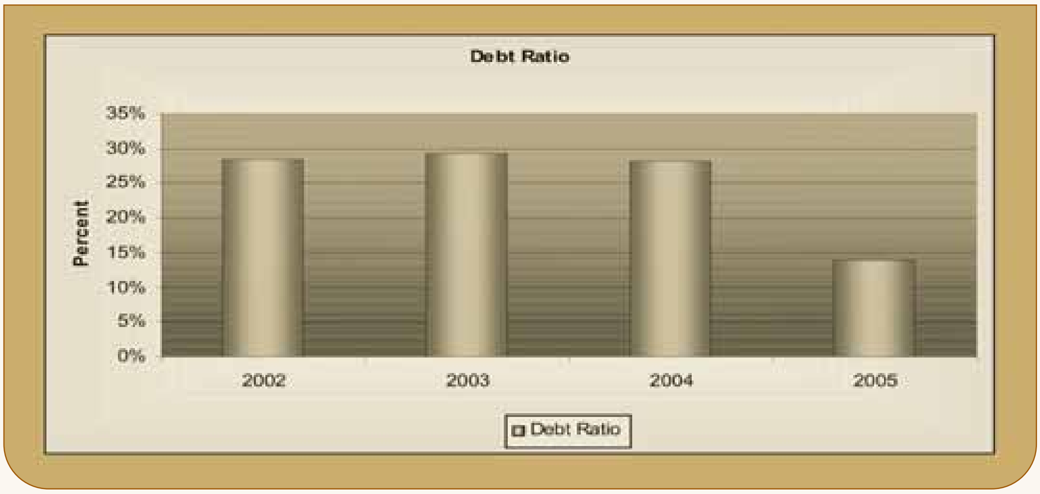
Financial Position

Group shareholder equity continued to improve over the period of review, with capital and reserves increasing from R336 million in FY 2001/02 to R522 million in FY 2004/05, the latter a 14.3% increase on the FY 2003/04 figures. Both the liquidity and solvency ratios showed a marked improvement in FY 2004/05 as illustrated below:



The liquidity ratio improved from 1.32:1 in FY 2001/02 to 1.61:1 in FY 2004/05, recovering from 1.38:1 in the prior year. Solvency ratio, at 2.26 in FY 2004/05, improved from 1.98 in FY 2003/04 and remained acceptable. Total liabilities increased from R329 million in FY 2001/02 to

R413 million in FY 2004/05 with the non-current component reducing from R39 million in FY 2003/04 to R23 million in FY 2004/05. The debt ratio improved from 33% to 20% similarly. The company therefore had a capacity to fund more activities through borrowings if the need arose without affecting the capital structure negatively. It is important to note that arivia.kom had enough cash on hand to settle all long-term debt without affecting its liquidity position:

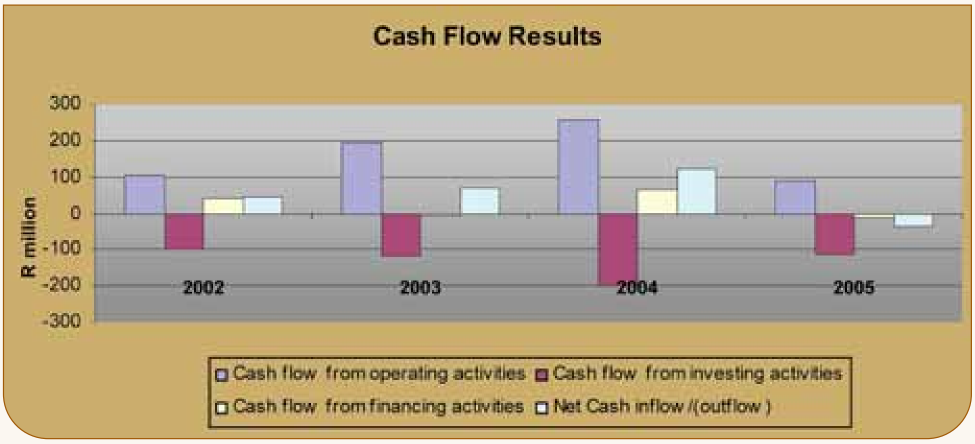


Cash Flow Results

The Group's cash and cash equivalents increased from R47.2 million in FY 2001/02 to R117.8 million in FY 2002/03 with a further increase to R241.8 million in FY 2003/04. These then decreased to R206.2 million in FY 2004/05.

Net cash flow from operating activities decreased with 65% from a positive inflow of R254.7 million in FY 2004/05 to a positive inflow of R87.6 million in the FY 2003/04. The decrease was mainly due to a material decrease in cash generated from operations - from R277.8 million in FY 2003/04 to R140 million in FY 2004/05.

It is clear from the graph below that the cash from operating activities decreased materially from FY 2003/04 (over and above the effect of income tax paid), which is supported by the decrease in operating activities (decreased revenue):



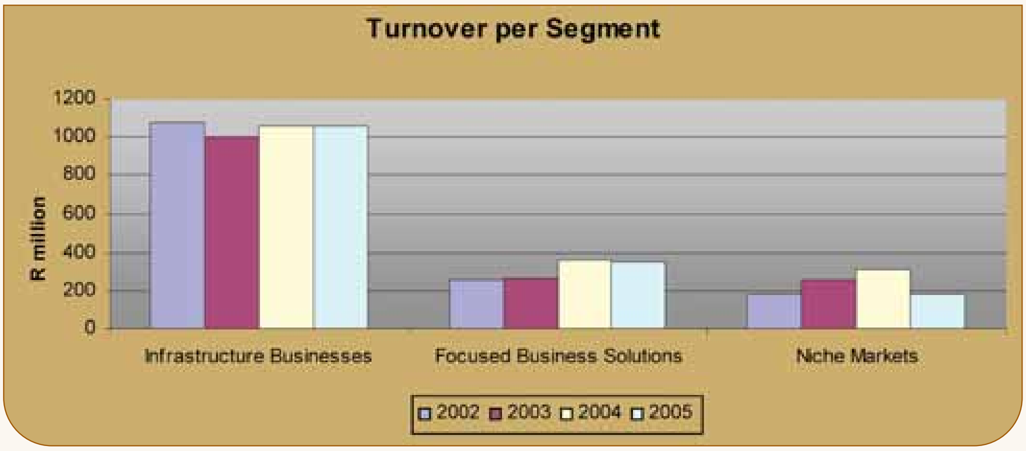
This decrease in cash from operating activities was also compounded by the reversal of the provisions as mentioned earlier. arivia.kom utilised existing cash reserves to fund its operating and investing activities.

Performance Per Segment

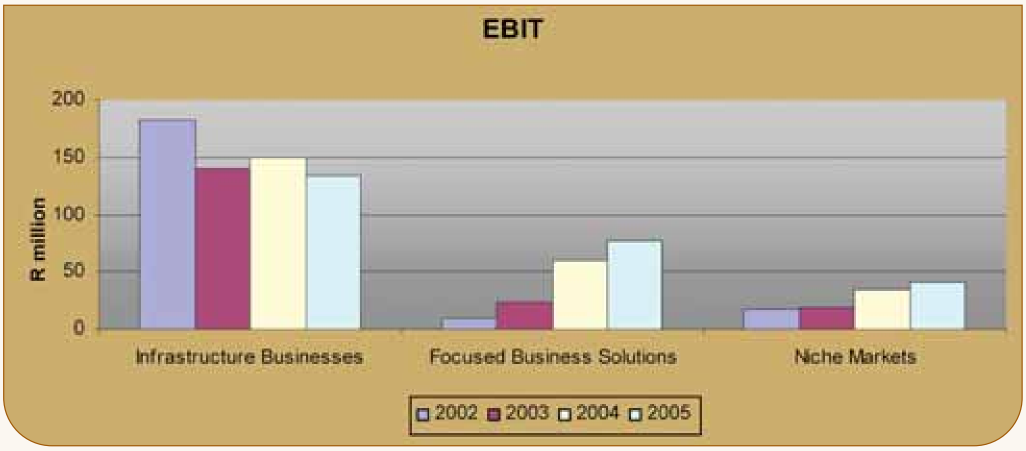
The segmental analysis discloses the contribution each segment makes to the overall company results. arivia.kom reports on three segments, being Infrastructure Business, Focused Business Solutions and Niche Markets. Each segment contributed to revenue as follows:

• Infrastructure Business	66.5%
• Focused Business Solutions	22.0%
• Niche Markets	11.5%

The following graph illustrates the composition of revenue:



The composition of EBITA (before corporate allocations) is depicted in the following graph:



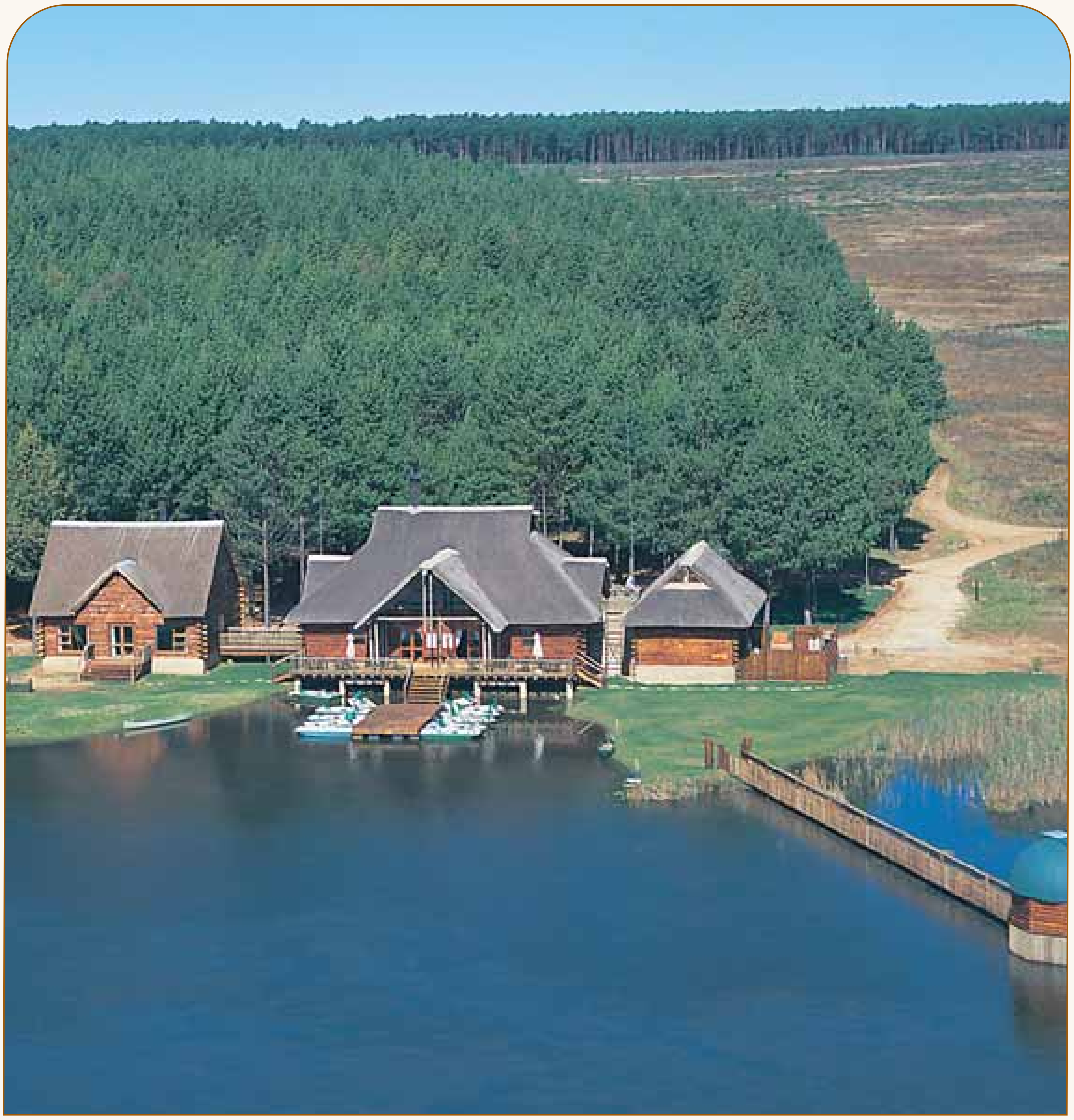
The above graphs indicate a possible decrease in the profitability of infrastructure business activities.

Contribution To Fiscus

The Board of arivia.kom decided not to recommend the distribution of a dividend to the shareholders. No dividend has been distributed since the inception of the company in FY 2001/02.

Government Exposure

Government did not issue any explicit guarantees to arivia.kom.



South African Forestry Company Limited

Safcol

Safcol In Perspective

Two major forestry packages, Eastern Cape North and KwaZulu-Natal, were disposed of in the 2001/02 financial year, while SAFCOL restructured its remaining forestry assets into three wholly-owned subsidiaries for privatisation purposes; Amatola Forestry Company (Pty) Ltd (AFC), MTO Forestry (Pty) Ltd (MTO) and Komatiland Forests (Pty) Ltd (KLF). Subsequently, 75% of the shares and shareholder's loans in AFC and MTO were sold during the course of FY 2004/05. Commercial closure was achieved for KLF in FY 2003/04 but the Competition Commission prohibited the proposed merger because of competition and public interest concerns. The preferred bidder and KLF appealed to the Competition Tribunal but withdrew their appeal and the transaction was subsequently cancelled.

Government is currently in the process of determining SAFCOL's future role in the forestry sector.

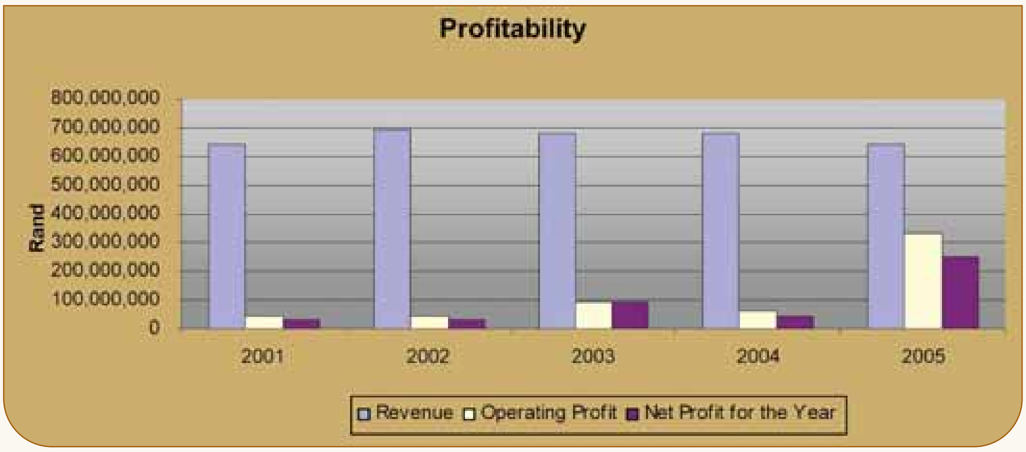
Performance

The SAFCOL Group achieved profit before tax of R373.1 million during FY 2004/05, a 369% increase over FY 2003/04 earnings, which totalled R79.6 million. Net profit increased from R31.8 million in FY 2000/01 to R251.7 million in FY 2004/05.

This performance can be attributed to the restructuring and privatisation in the Group, non-cash flow gains due to fair value adjustments of plantations as well as the Group's post-fire strategy to focus on the normalisation of operations and replant fire-damaged areas after the devastating forest fires of 2003. The increase in the value of standing timber can be attributed mainly to the impact of increased selling prices of round-wood logs achieved as a result of the buoyancy of the South African economy in general, increased activity in the building and construction sector and the decrease in log volumes available after salvage operations following the catastrophic forest fires experienced in FY 2002/03. Demand for logs and processed timber remained strong in FY 2004/05.

Financial Performance

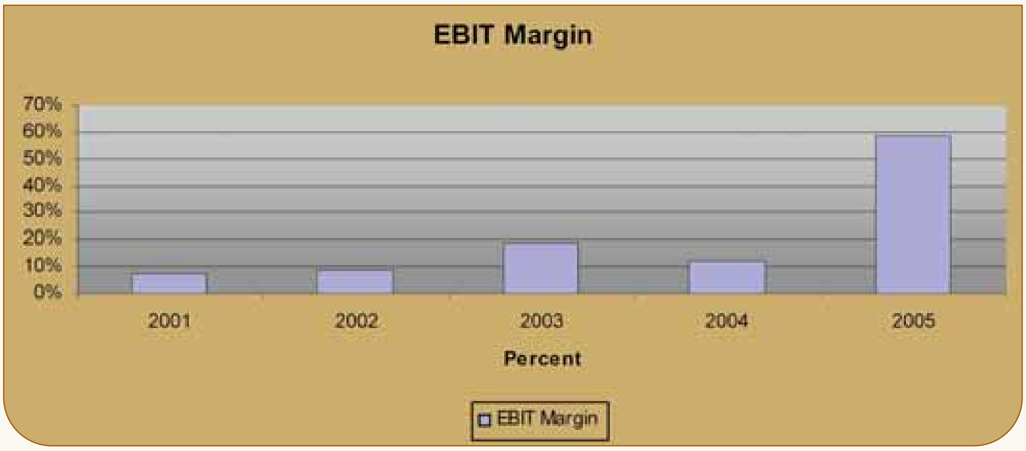
The graph below depicts the financial performance of SAFCOL over the period FY 2000/01 to FY 2004/05:



SAFCOL's revenue tended to fluctuate over the past 5 years, from R645 million in FY 2000/01 to R641 million in FY 2004/05, a reduction in both real and nominal terms. In FY

2001/02, revenue grew by 7.3% to R692 million and then dropped 2.2% to R677 million in FY 2002/03. Revenue in FY 2004/05 dropped by 6% compared with the FY 2003/04 figures. This reduction in revenue can be attributed to the disposal of the four forestry packages Eastern Cape North (FY 2001/02), KwaZulu-Natal (FY 2001/02), AFC (FY 2004/05) and MTO (FY 2004/05); as well as to the adverse effect of the forest fires in KLF in 2003/04 which resulted in reduced average log prices and increased operating costs in that year. The negative impact of the forest fires on log volumes available for processing is expected to continue for the next 15 to 20 years.

The earnings before interest and tax FY 2005 was R375 million (R46 million excluding the effect of AC 137) compared to FY 2003/04 at R82 million (R7 million excluding the effect of AC 137). These figures show that SAFCOL's remaining subsidiary is very profitable, considering that SAFCOL realised a loss of R55 million on the sale of the other two subsidiaries during FY 2004/05. The following graph depicts the historical movement in EBIT margins:



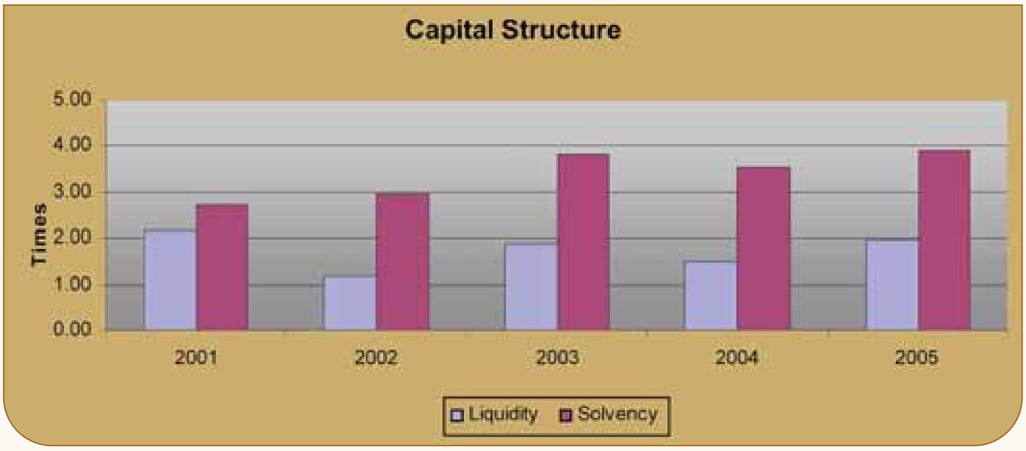
EBIT margin increased steadily from 7% in FY 2000/01 to 19% in FY 2002/03 before dipping to 12% in FY 2003/04, mainly due to changes in the cost structure in that year as a result of the catastrophic fires. The increase in the EBIT margin to 59% during FY 2004/05 is mainly due to positive fair value adjustments, amounting to R328.8 million, being included in operating profit (FY 2003/04 – R74.8 million). Fair values of plantations are based on the present value of net future cash flows from the asset, discounted at a market determined pre-taxation rate. The increase in the value of standing timber can be attributed mainly to the impact of increased selling prices of round-wood logs. It must be noted that the fair value adjustment can be positive or negative and does not represent cash flow; i.e. it can therefore not be deemed as part of sustainable income.

Net profit increased marginally from R32 million in FY 2000/01 to R33 million in FY 2001/02 with a significant increase in FY 2002/03 to R94 million. The decrease in net profit during FY 2003/04 (amounting to R43 million) was mainly due to devastating forest fires in the KLF plantations. These losses could not be recovered from the Group's external insurers, as SAFCOL was not able to secure insurance cover for standing timber since 1 August 2002. A net profit of R252 million was recorded in FY 2004/05, positively impacted by the fair value adjustments discussed above.

Financial Position

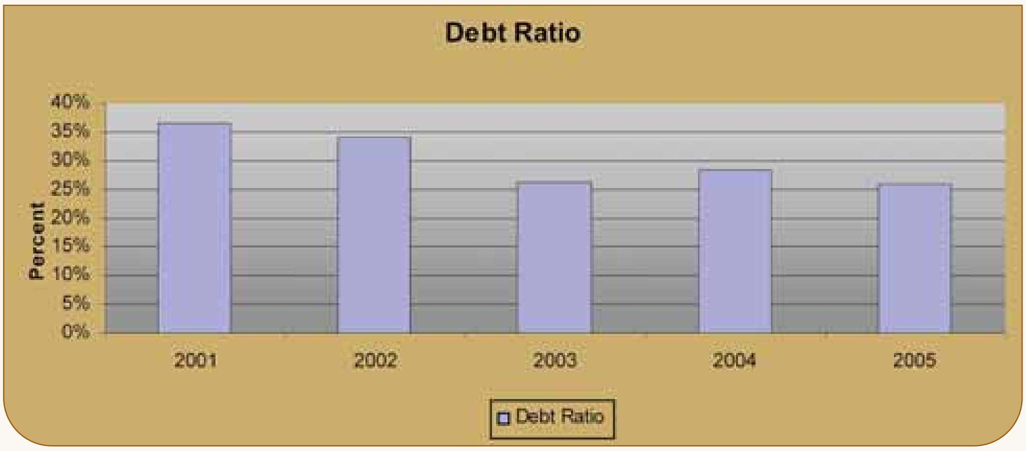
A marked improvement was recorded in the capital structure. Total capital and reserves grew steadily over the 5-year period reaching R1 036 million in FY 2004/05, with the growth in retained earnings making a significant contribution.

The graph below illustrates the movement in capital and reserves:



The current ratio showed a slight decline over the 5-year period from 2.15 in FY 2000/01, remaining just below the 2:1 threshold through to FY 2004/05 at 1.98. The ratio's decline pointed to a slight decline in liquidity, still within the theoretical benchmark of 2:1.

SAFCOL continued to improve it solvency, achieving solvency at 3.89 times in FY 2004/05, compared to 2.74 during FY 2000/01. The Group was funded mainly by internal capital and reserves, with contribution from debt negligible and declining as reflected in the Debt Ratio:

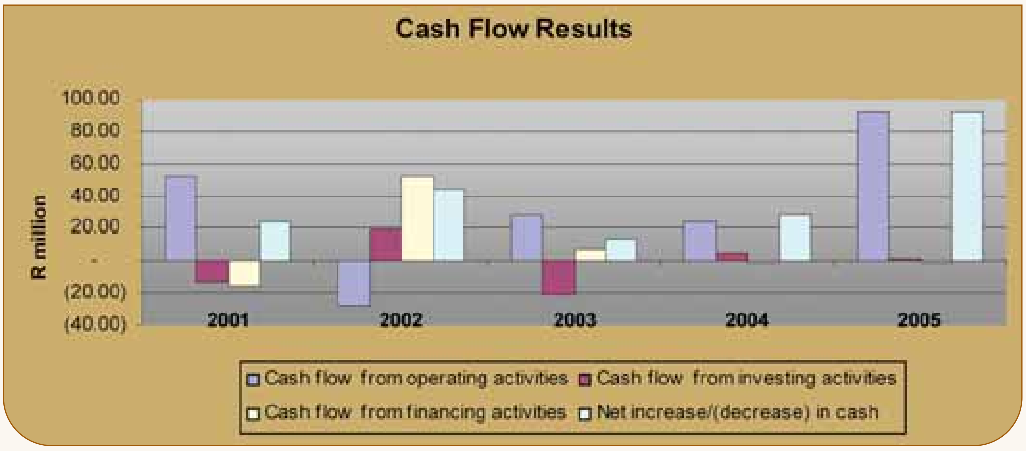


The debt ratio followed a steady declining trend to 0.26 in FY 2004/05, indicating improving gearing.

Cash Flow

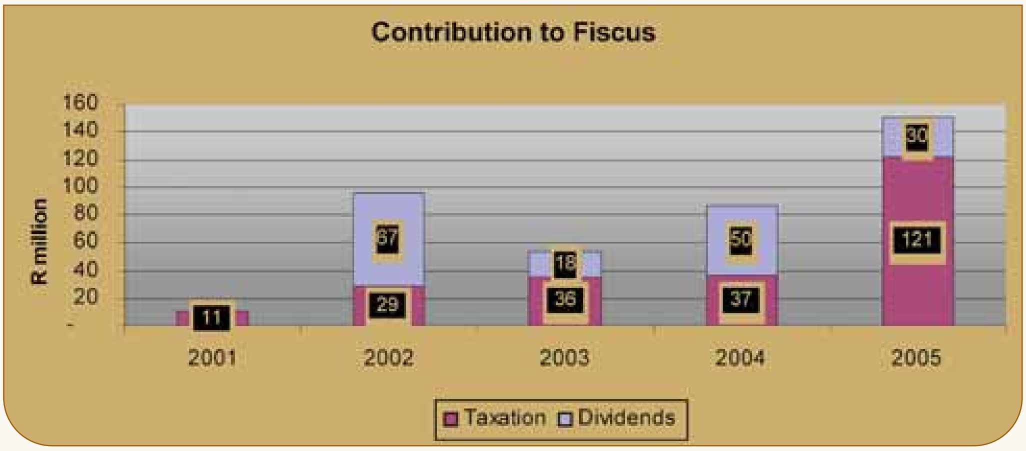
The Group generated varying degrees of net positive cash flows over the 5-year period except in FY 2003/04, when profit decreased materially due to the increased harvesting costs, fire fighting and extinguishing costs and clean up and rehabilitation costs following catastrophic forest fires. Cash flow from operating activities tended to fluctuate but generally exceeded net income, indicating good internal cash generation. Cash flow from operating activities increased to R92 million in FY 2004/05 as operations normalized following the post-fire cleanup.

The ratio of cash flow from operating activities to net income followed a similar pattern over the 5-year period. The ratio, at 1.36 in FY 2004/05, indicates that earnings were backed-up by cash.



Contribution To Fiscus

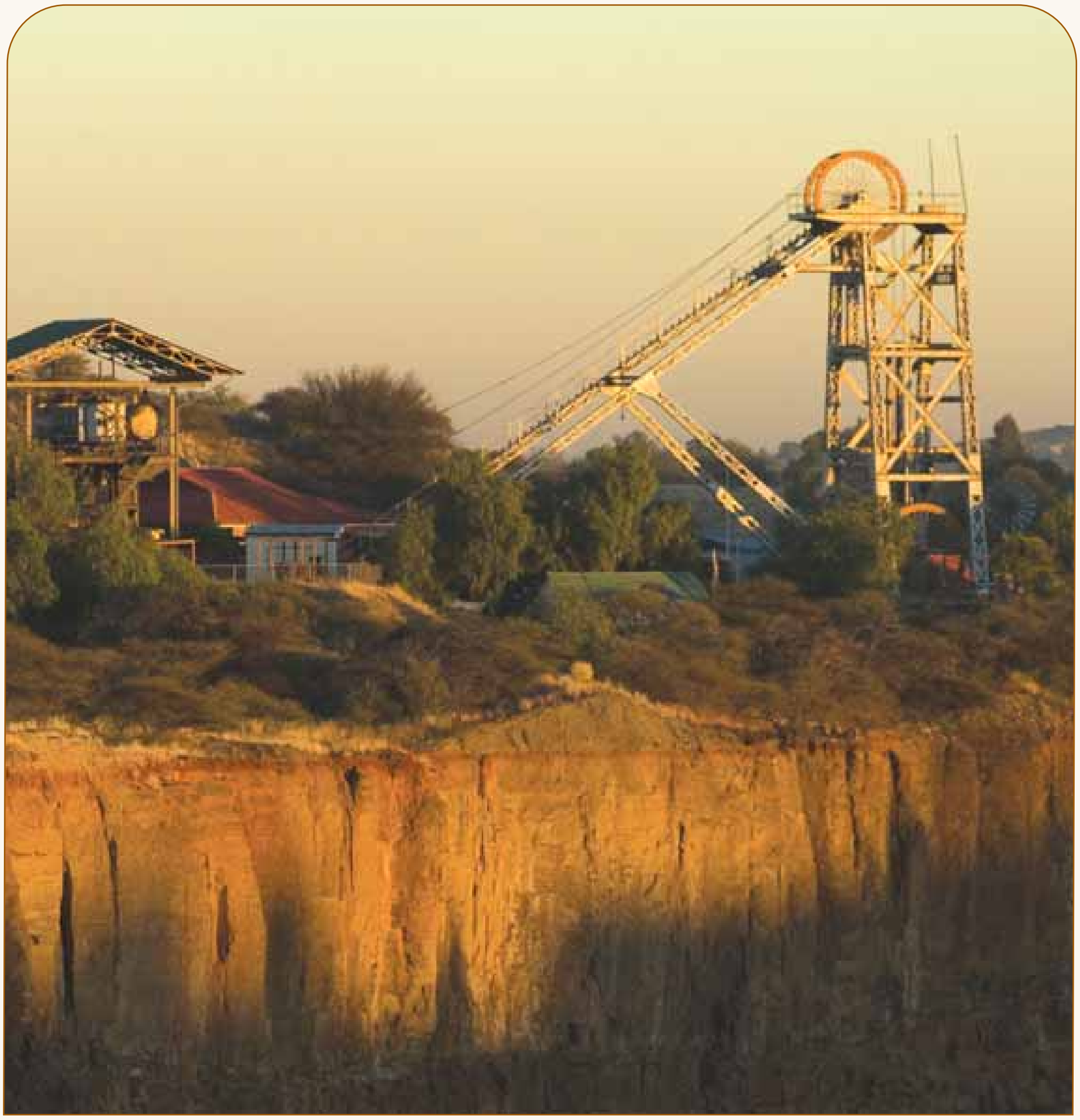
The following table depicts SAFCOL's contribution to the fiscus over the 5-year period through dividends (including special restructuring dividends) paid to government as shareholder and normal tax[11] (including Secondary Tax on Companies):



Government Guarantees

No government guarantees were issued to SAFCOL over the period of review.

[11]As per Value Added Statements, includes charges for Deferred Tax



Alexkor Limited

Alexkor

Alexkor In Perspective

South Africa has the most diverse range of diamond deposits in the world. Deposits include open pit and underground kimberlite pipe/dyke/fissure mining, alluvial mining as well as on and offshore marine mining. South Africa's diamond industry produces a stable 10 million carats annually, of which 90% is exported. South Africa produces 9% of global production and is ranked fourth in the world in terms of rough diamond production.

Most production is sourced from kimberlite mines (9 million carats), followed by alluvials (920 000 carats) and marine (64 000 carats).

Diamond mining is the backbone of the Namaqualand economy and makes the largest contribution to labour remuneration in the region. Alexkor owns mining rights over a large marine and land based diamond resource. Alexkor has two divisions: Alexander Bay Mining Company (ABM) and Alexander Bay Trading Company (ABT). ABM currently mines the land and sea concessions while ABT is involved in agriculture and trading. Although not the largest employer in Namaqualand, Alexkor provides employment to approximately 1,500 people in the region directly and indirectly.

Alexkor currently maintains and provides basic municipal services including the supply of potable water in the Alexander Bay and Beauvallon towns. It also provides housing, water and electricity to its employees and contractors at subsidised rates. The company provides health care services in the town and surrounding Richtersveld communities and maintains an airport in conjunction with ATNS.

The Richtersveld community lodged a claim with the Land Claims Court. The outcome of this process is expected in the second quarter of 2006 and this could result in a complete shift in the manner in which Alexkor operates. Alexkor may have to review its business.

The company has experienced key business constraints in recent years. These are outlined below:

- Alexkor owns mineral rights over a large land area and diamondiferous marine deposits. However, there is a lack of an identifiable diamond reserve base and the mining operations are currently exploiting an inferred resource.
- Land mining operations have been a major loss maker (between R2 m and R9 m per annum) and the current area mined is largely depleted.
- Marine operations have consistently operated at a profit. However, total carat production has shown a continual decline since 2001 mainly due to a decline in marine production. Challenges exist with respect to the productivity of marine contractors.
- Costs have not declined relative to revenue decline in recent years.
- Plant infrastructure equipment levels and staffing levels have not seen adequate investments and are inadequate to support a major exploration programme.
- No major exploration plans have been implemented in recent years, with the exception of R25 million spent on the exploration programme in 2003/04 and the purchase of 2 infield screening plants and 2 rigid haul trucks.

- The provision for rehabilitation costs as at March 2005 was R33.6 m. Community services provided by Alexkor incurs costs. These costs are approximately R2.3 m for health services, R3 m for municipal services and R0.252 m for maintenance of the airport per annum.
- There are weaknesses in compliance with sound corporate governance practices e.g. procurement and tendering processes, internal controls and procedures, and failure to comply with PFMA requirements

The above constraints have resulted in Alexkor operating at a loss with an erosion of cash resources. As a result, the DPE has placed a significant amount of emphasis on monitoring its financial performance. Alexkor's Board and Management adopted a turnaround strategy aimed at improving the company's performance. Significant commitment will also be required from the Board in ensuring that appropriate corporate governance policies and mechanisms are put in place.

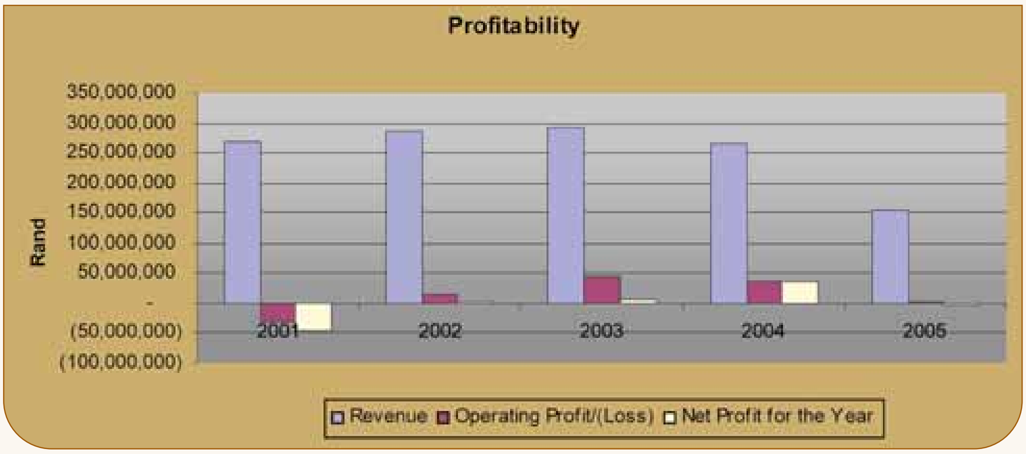
There is a drive to transfer the municipal services to the local municipality, which should alleviate some of the costs associated with providing such services in the future. Land exploration has also been hampered due to the uncertainties regarding the outcome of the legal proceedings. The company has proposed interventions to increase diamond production, which includes alternative mining methods in its sea concession areas. Furthermore, an exploration programme needs to be developed for the company to take advantage of potential reserves in the Alexander Bay area.

Performance

Alexkor's financial year-end was changed from 30 June to 31 March 2005 to bring it in line with government's year-end. The FY 2004/05 results therefore cover a 9-month period. However, for purposes of comparison, analysis of the financial performance and cash flow results has been restated as far as possible to a 12-month period.

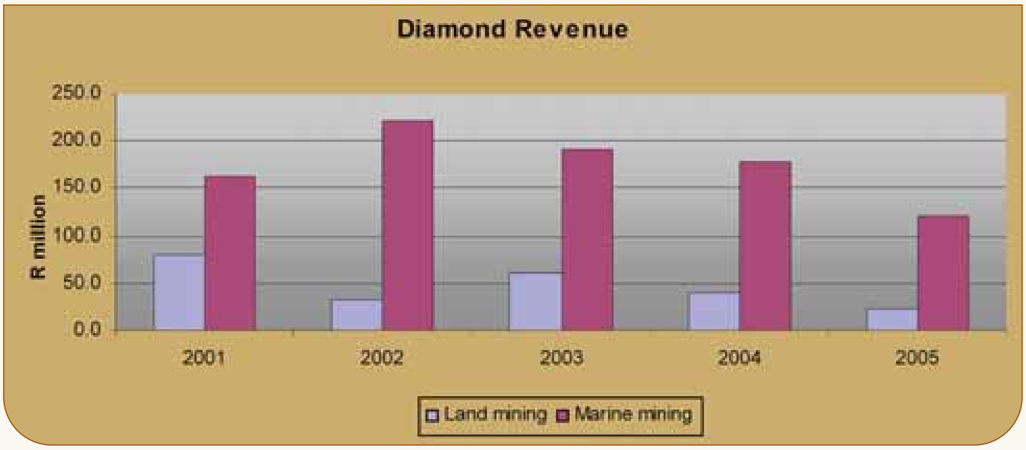
Financial Performance

Alexkor has a chequered financial history, as depicted in the following graph:



The company recorded a net loss of R4.7 million in FY 2004/05 following a net profit of R35.7 million in FY 2003/04, coming from a net loss of R45.4 million in FY 2000/01. Revenue has declined from R269 million in FY 2000/01 (12-months) to R152 million in FY 2004/05 (9 months). Revenue would only have amounted to an estimate of R190 million if the FY 2004/05 represented 12 months.

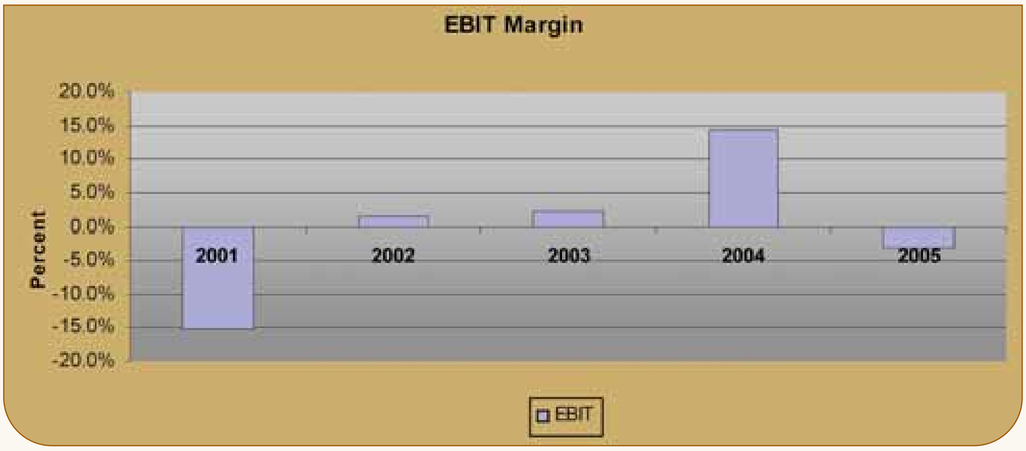
This decline in revenue is attributed to a decrease in mining production as well as losses incurred from Alexander Bay Trading (ABT) activities. Adverse weather conditions resulted in a reduction in available "sea-days" for shallow marine mining activities. As a direct consequence, carat production reduced significantly. There were also no deep-sea marine mining activities during FY 2004/05 due to fact that Alexkor does not own or have access to appropriate deep-sea mining vessels. The table below depicts the change in diamond revenue over the years, as well as the source of the diamonds:



The demand for rough diamonds remains strong with Alexkor experiencing an average US dollar price per carat increase of 15% in FY 2004/05. Actual diamond prices remained predominantly above budgeted prices over the 5-year period. While the stronger Rand affected the company, the price increases helped to boost the total sales revenue.

ABT is a division of Alexkor Limited that operates all non-core activities of the company including ostrich farming, dairy, aquaculture and other agricultural activities. ABT made a loss of R5.5 million in FY 2004/05 compared to a loss of R82.3 million the previous year. These losses can be attributed to the significant reduction in maize prices as well as the bird flu virus, which affected the ostrich market.

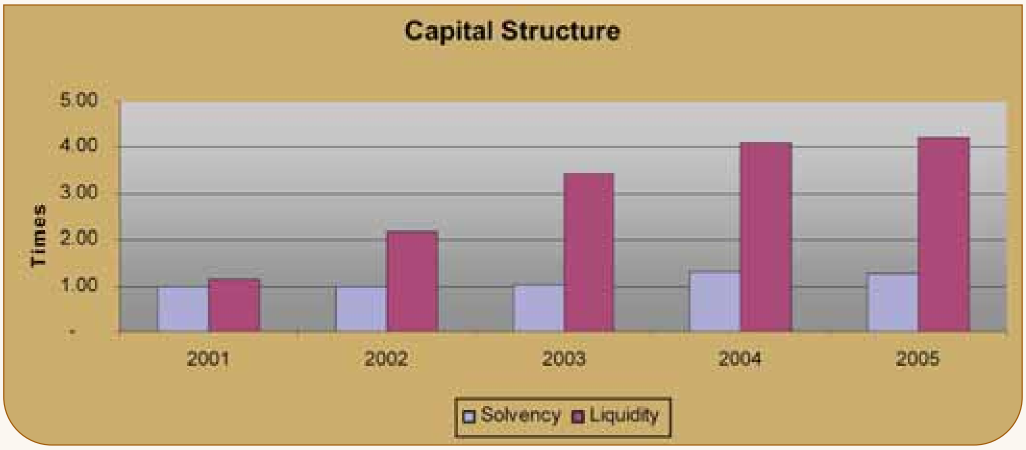
The following table depicts Alexkor's profitability in terms of earnings before interest and tax profit margins for the period under review:



The EBIT margin achieved in FY 2003/04 was 14.4%, which reduced to minus 3.1% in FY 2004/05. The deterioration is mainly due to the lost contribution of mining activities, which should have contributed to covering the fixed costs of Alexkor. Operating costs have declined significantly as a result of a slow-down in Alexkor's mining activities and savings related to revenue splits with contractors. Operating costs amounted to R201 million in FY 2004/05 compared with R301 million in FY 2000/01.

Financial Position

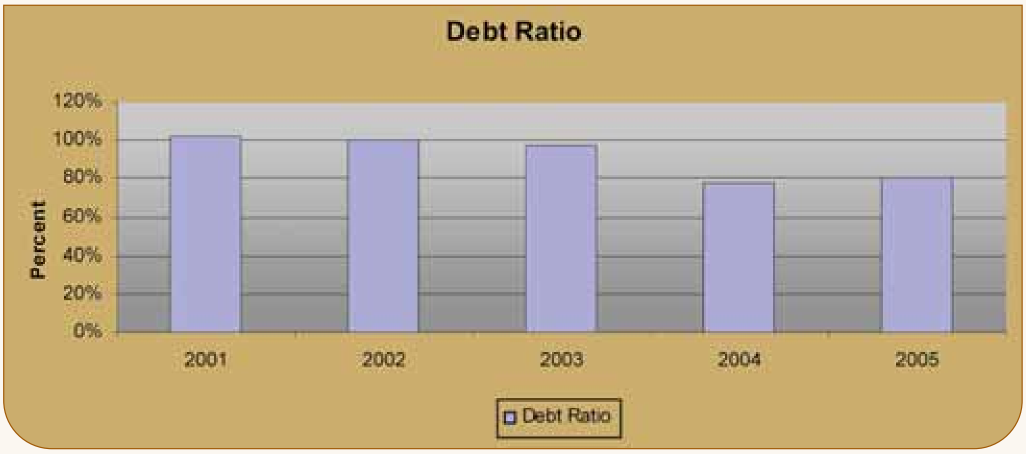
The net capital and reserves of Alexkor improved between FY 2000/01 at minus R2.9 million to a positive R40.3 million during FY 2003/04 and then deteriorated to R35.5 million in FY 2004/05 due to the net loss. The movement in liquidity and solvency is illustrated below:



The current ratio has shown a steady improvement from 1.14 in FY 2000/01 to 4.21 in FY 2004/05 indicating increasing liquidity. This may be partly attributed to the increase in inventories held. Solvency was restored during FY 2001/02 to 1 from 0.98 during FY 2000/01.

However, solvency remained very low at 1.25 times cover for FY 2004/05. The difference between the improved liquidity ratio and stagnant solvency ratio was mainly due to the impact of non-cash provisions relating to post-retirement benefits, pension fund liabilities and provisions for rehabilitation.

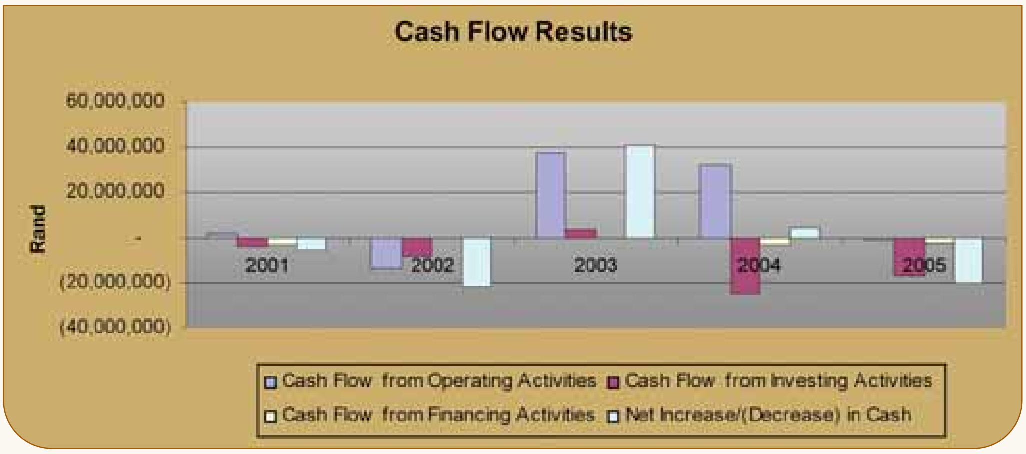
The following graph illustrates the improvement to the debt ratio, showing a downward trend through to FY2004/05:



However, the debt ratio still remains very high with provisions representing 100% of debt, with zero external funding.

Cash Flow

The following graph illustrates the cash flow results of Alexkor over the period of review:



Alexkor generated net negative cash flows in FY 2000/01 and FY 2001/02. In FY 2002/03, however, a net positive cash flow of R40.6 million was recorded. This reduced to R4 million the following year. It further deteriorated in FY 2004/05 with a net outflow of R19.9 million.

Important points to note include:

- Additions to property, plant and equipment, which mainly relate to capital expenditure to maintain operations as well as exploration costs capitalised. No revenue was earned from the exploration activities and thus no return on investment;
- Inventory has been increasing, reaching R40.3 million in FY 2004/05;
- Cash and cash equivalents fluctuated over time, decreasing to R51.5 million in FY 2004/05 compared with R71.4 in FY 2003/04. The decrease can be attributed to the cash utilised to fund the losses, capital expenditure and cash contributions to the Rehabilitation Fund.

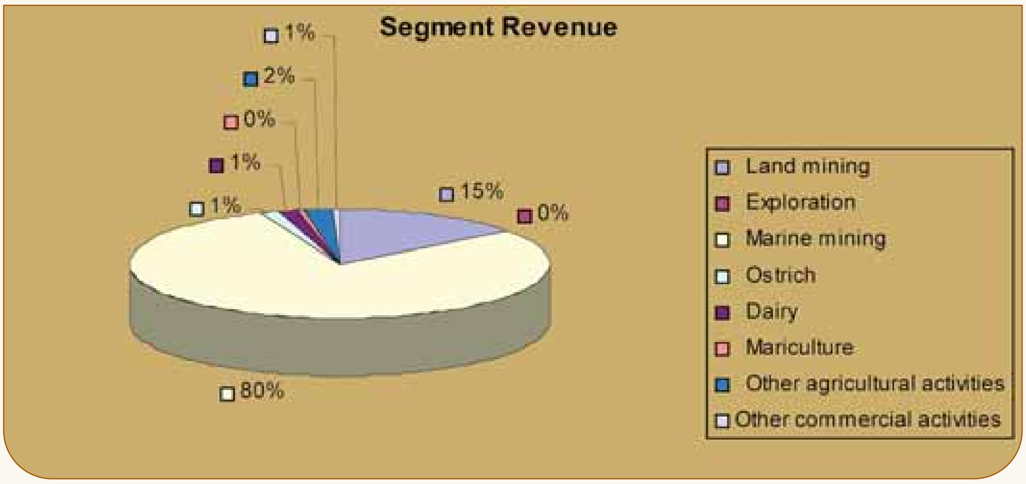
In FY 2004/05, cash outflows from operations of R0.6 million were derived from normal operating activities while cash flows from investing activities of R16.7 million were mainly due to capital purchases of R17.7 million and the exploration cost incurred. During that year, none of the operations were financed from external sources.

Performance Per Segment

Alexkor can be split into 3 main segments:

1. Mining
   - Land mining
   - Exploration
   - Marine mining
2. Farming
   - Ostrich
   - Dairy and meat
   - Aquaculture (oysters)
   - Other agricultural activities
3. Other commercial activities
   - Airport
   - Municipality services
   - Guest houses

The following chart shows the contribution of each sector to the total revenue of Alexkor:

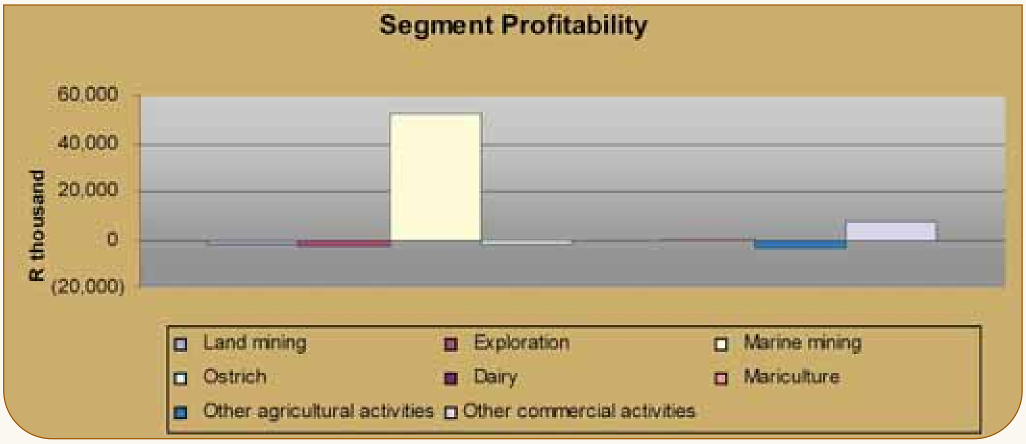


It is evident that the largest contribution to Alexkor's revenue comes from marine mining. This alone constituted 80% of total revenue in FY 2004/05 while land mining contributed 15% and the farming segment 4%.

The company incurred a net loss from operations of R874 000. The contributors to the loss were:

- Land mining: R1.7 million loss
- Exploration: R2.2 million loss
- Ostrich farming: R1.7 million loss
- Other agricultural activities: R3.2 million loss.

This is depicted in the following chart for the period ending 31 March 2005:



Contingent Liabilities

Land Claims: During FY 2004/05, the Richtersveld community successfully claimed that the land on which the company operates be restituted back to it. The claim was against government and it is expected that the costs to restitution will be borne by government.

Nabera Mining: Alexkor is defending a claim by Nabera Mining, a firm previously engaged to run Alexkor's operations. Alexkor disputes the amount of value added by the firm as well as management fees claimed by Nabera. No provision has been made for the potential liability.

Contribution To Fiscus

Alexkor has not been able to declare dividends during the period under review. As Alexkor has an assessed tax loss as at 31 March 2006, no income tax has been paid to government during the period of review.

Government Guarantees

No government guarantees were issued to Alexkor over the period of review.

Definitions

Revenue: This is the amount of money that a company receives through its business activities during a specific period. It is calculated by multiplying the price at which goods or services are sold by the number of units or amount sold.

Expenses: This is money spent by a company to continue its on-going operations and results from performing activities necessary to generate revenue.

Net income: A company's total earnings (or profit). Net income is calculated by taking revenues and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses.

Earnings before interest and tax (EBIT): An indicator of a company's profitability. It is calculated as revenue minus expenses, excluding tax and interest. EBIT is also referred to as "operating earnings", "operating profit" and "operating income".
EBIT = Revenue – Operating Expenses

EBIT Margin - EBIT expressed as a percentage of revenue.

Profit margin: A ratio of profitability calculated as net income divided by revenue.

Assets: Resources having economic value that a company owns or controls. They may be categorised as current (assets that are expected to be converted into cash or used up within one year or the normal operating cycle of the company) or non-current assets.

Liabilities: A company's legal debts or obligations that arise during the course of business operations. These may be categorised as current (those due in one year or less) and non-current (which have a maturity of greater than one year).

Liquidity: A company's ability to satisfy maturing short-term debt.

Current ratio: A model for measuring liquidity of a company. It is obtained by calculating the ratio between all current assets and all current liabilities.

Solvency: The ability of a company to meet its long term fixed expenses and to accomplish long-term expansion and growth.

Solvency ratio: Indicates the company's ability to meet its long-term obligations.
Solvency ratio = net worth / total assets

Debt ratio: Indicates what proportion of debt a company has relative to its assets and is calculated by dividing total debts by total assets.

Equity: The amount of funds contributed by the company's shareholders plus the retained earnings. It is also known as net worth. It is calculated as: Equity = total assets – total liabilities.

Debt / Equity ratio: Indicates what proportion of equity and debt the company is using to finance its assets. It is calculated by dividing total liabilities by equity.

Retained earnings: The percentage of net income not paid out as dividends but retained by the company to be reinvested into core business or to repay debt. It is calculated by adding net income to beginning retained earnings and subtracting any dividends paid out.

Dividend: The distribution of a proportion of a company's earnings to its shareholders.

Fair value: This is the amount an asset could be bought or sold in a current transaction between willing parties, other than in liquidation.

Cash flow return on investment (CFROI): This is an economic performance measurement that adjusts for distortions that make comparisons among companies difficult. CFROI ties performance measurement to the ability of the company to generate cash flow and is an approximation of the average real internal rate of return earned by a company on all its operating assets. It is normally calculated on an annual basis and is compared to an inflation-adjusted cost of capital to determine whether a company has earned returns superior to its costs of capital.
CFROI = Cash Flow / Market value of capital employed

Notes

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