ANALYSIS OF THE PERFORMANCE OF STATE-OWNED ENTERPRISES DURING THE PERIOD 2003/4 - 2007/8

public enterprises
Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

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FOREWORD

BY THE MINISTER OF PUBLIC ENTERPRISES

South Africa faces the developmental imperative of accelerating its economic growth rate, while simultaneously halving the levels of unemployment and poverty of its population. The developmental state, driven by its long-term economic vision, must understand and adapt this growth strategy to the opportunities and challenges provided by both the local and global economic climate. The strength of the developmental state also lies in its ability to determine the best way to achieve these objectives.

In the 2003/04 period, the Accelerated and Shared Growth Initiative (ASGISA) was introduced, and it brought with it a strategic shift in the perceived role of state-owned enterprises (SOE) in the economy. Prior to this period, the focus was on the restructuring and privatisation of these enterprises. Through ASGISA, the role of SOE in supporting a growing economy was more explicitly articulated. SOE falling under the responsibility of the Department of Public Enterprises (DPE) operate in key strategic areas of the economy, including energy, telecommunications and logistics infrastructure. These areas lay the critical foundation for more sustainable economic growth. The SOE also operate in the area of advanced manufacturing, which is a critical area for growth and skills development. It is important that the SOE are viable businesses which provide economic benefits to the country. As the Department of Public Enterprises (DPE), we were tasked with carrying out this mandate on behalf of Government.

In the five years under review, the SOE were concerned with streamlining their operations, disposing of non-core assets, and in the case of Eskom and Transnet, gearing for the massive capital expansion programmes they are currently undertaking.

The Five-year Review of the SOE is an opportunity to reflect on their performance not only as individual enterprises, but also with respect to Government's overarching goal of growth and development.

The performance of the SOE has to-date been driven by each SOE's unique set of circumstances, whether it relates to its management team, or the industry in which it operates. The SOE currently falling under the DPE are: Alexkor, Broadband Infraco, Eskom, PBMR, SAA, SAX, SAFCOL, Denel and Transnet. The SOE vary in maturity, and as you will see in this review, they have, to a large extent, been analysed individually.

While a great deal has been achieved in the five years to 2007/08, much more challenging tasks lie ahead for the Department and the SOE reporting to it. The SOE boards and management teams have done a tremendous job in turning these entities around and positioning them for growth. I am confident that as we forge ahead, the Department will continue to improve in its oversight role, and that the SOE will deliver not only on their bottom line, but on their socio-economic imperatives as well, in the interests of a stronger developmental state.

The importance of the SOE means that we need to ensure that we adjust the governance and capitalisation processes to meet the challenges ahead. There is a need to more effectively balance the strategic intent of the State and the necessary flexibility to respond to commercial, technological and global change. These are matters for policy debate and future implementation.

Alec Erwin
Minister of Public Enterprises

BY THE DIRECTOR-GENERAL

In 2004 when the Accelerated and Shared Growth Initiative (ASGISA) was launched, the Department of Public Enterprises (DPE) was given the challenging task of ensuring that state-owned enterprises (SOE) reporting to it played a more significant role in the growth and development of the South African economy.

The SOE are responsible for strategic investments in key sectors of the economy, including energy and telecommunications. The Department has directed these SOE to adopt targeted long-range strategic interventions to enhance their impact on the economy. The capital expansion programmes of Eskom and Transnet are but two examples.

The Department's objective has been to direct the SOE within its portfolio to align their strategies with the overall objectives of Government – those of sustainable economic growth and employment creation - and to mitigate the effects on the balance of payments of the large build programme with its associated capital good imports.

This review looks at the performance of the SOE since the 2003/04 financial year, and highlights the challenges these enterprises face currently.

Some of the SOE remain loss-making, with weak financial positions, and they continue to be undercapitalised. However, on a year on year basis their performance is improving. The balance sheets of the network infrastructure SOE are placed under strain as their massive investment programmes require more borrowings from both the local and international markets. To further compound the situation, the regulatory framework is changing and requires close attention by the SOE and the Shareholder Department to ensure a coherent economic model that enables investment in new infrastructure, whilst ensuring the protection of poor households and SME.

Despite these challenges, we continue to work with our SOE and all stakeholders to ensure that they are sustainable businesses, which contribute to the growing economy.

We have recently added two stand-alone SOE to the DPE portfolio – South African Express (SAX) and Broadband Infraco. In the coming years we will be able to get a clearer picture of their individual performance, as well as their performance within the portfolio.

The past five years have indeed been a steep learning curve for all of us at the DPE and the SOE reporting to the Department. While we are pleased with the progress the SOE have made in their various turnaround strategies, and with the way in which we, in our shareholder role, have refined our oversight management tools to better manage these enterprises, we are acutely aware of the work that still lies ahead.

The DPE is focused on building a developmental portfolio of efficient and financially sustainable enterprises that promote the country's capacity in infrastructure provision, in targeted areas of advanced manufacturing, whilst containing their impact on the balance of payments, thereby contributing to the stability and growth of our economy. The next few years will therefore be critical as we work to ensure that the SOE deliver on this mandate.

Portia Molefe
Director-General: Department of Public Enterprises

GLOSSARY OF FINANCIAL TERMS

Assets are resources having economic value that a company owns or controls with the expectation that they will provide future benefit. They may be categorised as current (assets that are expected to be converted into cash or used up within one year of the normal operating cycle of the company) or as non-current assets.

Cashflow Return on Investment (CFROI) 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 cashflow 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. It is cashflow divided by the market value of capital employed.

Current Ratio measures a company's ability to pay short-term obligations. The ratio is used to give an idea of the company's ability to pay back its short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables). It is obtained by dividing current assets with current liabilities.

Dividend is a distribution of a portion of a company's earnings to its shareholders.

EBIT: Earnings Before Interest and Tax is an indicator of a company's profitability, calculated as the operating profit less all expenses excluding interest and tax.

EBITDA: Earnings Before Interest, Tax, Depreciation and Amortisation

EBIT Margin is a profitability measure equal to EBIT divided by net revenue.

Financing cashflow is the net cashflow generated or utilised by a company due to its activities in increasing or decreasing its level of debt.

Gearing ratio is derived by dividing the total liabilities by equity. Gearing is a measure of financial leverage, demonstrating the degree to which a firm's activities are funded by owner's funds versus creditor's funds.

Interest Coverage ratio is used to determine how easily a company can pay interest on outstanding debt. The interest coverage ratio is calculated by dividing a company's EBIT of one period by the company's interest expenses of the same period.

Investing cashflow is the net cashflow generated or utilised by a company due to its investment activities.

Liabilities are 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 is a company's ability to satisfy maturing short-term debt.

Net cashflow is the total cashflow effect of all activities of a company.

Net Profit Margin is a ratio of profitability calculated as net income divided by turnover.

Net Profit/Loss is a company's profit after all expenses have been deducted from total income. This is calculated by taking revenue and adjusting for the cost of doing business, depreciation, interest, taxes and other expenses.

Operating cashflow is the cash generated by a company out of its normal business operations.

Operating Profit is an indicator of the profitability of a company's sales after costs that are directly attributable to sales have been deducted.

Return on Assets is an indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. It is calculated by dividing a company's net income by its total assets,

Return on Equity is a measure of a company's profitability that reveals how much profit a company generates with the money shareholders have invested. It is calculated by dividing a company's net income by shareholder equity.

Revenue is the amount of money that a company receives through its business activities during a specific period.

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

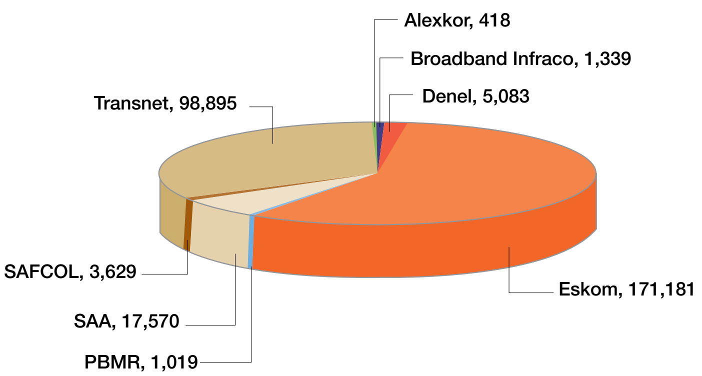
1. INTRODUCTION

The Department of Public Enterprises (DPE) provides oversight management to State-owned Enterprises (SOE) to ensure that they are sustainable businesses that provide economic benefit to the country. The focus of the DPE role on financial performance – as captured in the PFMA and interpreted through shareholder compacts concluded with the individual SOE – has been a consistent theme.

During the period under review, the DPE portfolio of SOE consisted of key established and emerging network infrastructural providers (Eskom, Transnet and Broadband Infraco), a full service network airline (South African Airways), a player in advanced military aerospace and defence manufacturing (Denel), a major technology development initiative (Pebble Bed Modular Reactor), a forestry company (SAFCOL) and a diamond mining company (Alexkor).

The chart below illustrates the relative size of the above SOE by asset base in 2007/08:

Relative size of SOE by Asset Base (R 'million)



*** PBMR is in project phase.**

Up to the end of the 2003 financial year, the SOE were focussed on the implementation of restructuring and privatisation initiatives. From the beginning of the 2004 financial year, the DPE strategy was changed to direct the SOE in its portfolio to focus on the consolidation of core services that supported a strategic purpose in the economy and the disposal of non-core assets and operations. This strategy also aligned SOE business strategies with sector department policies and regulatory authorities. The DPE's overarching objective has been to direct the SOE in its portfolio to align its strategy with the needs and policy direction of the domestic economy. This consists of two major elements. The first is the positioning and/or entry of SOE in pursuit of industry or sectoral policies. The second is the development and promotion of policies by the DPE that enhance the operation of SOE and the engagement within the broader South African legislative context. In addition to the focus on a core strategic purpose, the DPE has directed key SOE to adopt targeted long-range strategic interventions to enhance their impact on the economy. The SOE portfolio is focussed on key strategic sectors and is consequently key to Government's ability to deliver on accelerated and shared economic growth targets.

At present the DPE conducts its mandate in relation to SOE by interacting with each entity on an individual basis. The focus on core activities that support a strategic purpose in the economy combined with targeted long range strategic interventions has effectively laid the foundation for the introduction of a portfolio approach to the management of the SOE. The DPE is focussed on building a developmental portfolio of efficient and financially sustainable enterprises that promote South Africa's strategic national capacity and capability in infrastructure provision and in targeted areas of manufacture. Measurement of the performance of the portfolio will be by key performance indicators relating to the increase in economic value of the portfolio as well as the contribution of the portfolio to supporting the development of strategic capacities and capabilities. The indicators serving to measure the aggregate performance of the SOE portfolio are as follows:

- Return on Capital Employed (ROCE) – measuring the ratio of operating profit, resulting from the business operations of the SOE, and assets (property, plant and equipment, and working capital requirement). This measures effective value-creating capacity relative to resources utilised;
- Return on Equity (ROE) – the ratio between profit (combining operating profit and net finance cost) and capital and reserves. This highlights SOE wealth-creation;
- Operating Margin – the ratio between operating income and revenue to indicate the value added actually generated by the SOE operations with its revenue; and
- Debt Sustainability – the relationship between SOE EBITDA generated and SOE net debt (current and non-current liabilities less cash and cash equivalents). The inverse measures how many years of EBITDA would be needed to repay net debt in full, all other things being equal.

This report, based on audited results is the five-year review of the performance of the above SOE covering the financial years from 2003/04 to 2007/08. Between 2003/04 and 2006/07 financial years, restated figures have been used wherever applicable. The purpose of the review is to provide the public and all stakeholders with an overview of the performance of SOE in the DPE's portfolio.

The table below gives an overview of the portfolio performance:

An increase in portfolio assets has been recorded over the period of the review, from R192.1 billion in 2003/04 to R298.2 billion in 2007/08 with asset growth recorded across all SOE. Portfolio equity has also shown strong growth from R49.7 billion to R123.1 billion in 2007/08 with equity growth recorded in Denel, SAA, Transnet, Eskom and the addition of Broadband Infraco to the portfolio. Transnet and Eskom embarked on massive infrastructure investment programmes to address constraints in logistics and energy infrastructure

	2003/4	2004/5	2005/6	2006/7	2007/08
ROCE	10.0%	12.0%	9.6%	9.5%	6.7%
ROE	-23.9%	15.7%	10.0%	13.0%	3.7%
Operating margin	12.3%	20.2%	20.7%	20.1%	15.2%
Debt sustainability	5.0%	18.0%	18.1%	18.3%	14.1%

Total portfolio revenue grew from R98.3 billion in 2003/04, dipping to R84.5 billion in 2005/06 before recovering to R101.7 billion in 2007/08. Eskom and Transnet contributed 44% and 30% of total revenue, respectively. Portfolio EBIT increased from R12.1 billion in 2003/04 to reach R18.4 billion in 2006/07. In 2007/08, however, EBIT fell by 19% to R15.4 billion while portfolio net profit reduced by 66% to R4.5 billion due to reduced profitability in Eskom, Transnet, Safcol and increased loss in SAA. Operating margin profit reduced to 15.2% in 2007/08.

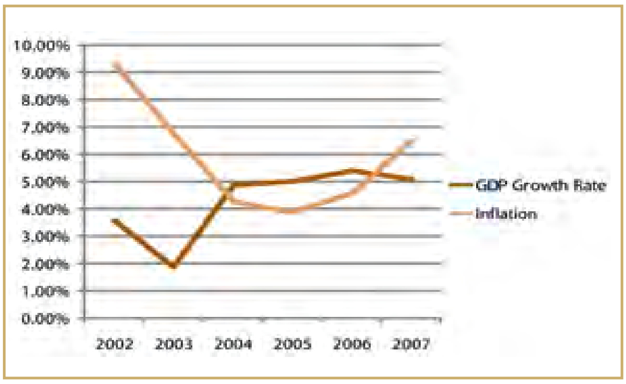
and capacity in South Africa. The impact of the capital investment programme resulted in ROCE reducing from 12% in 2004/05 to 6.7% in 2007/08. Overall ROE also declined due to the build programme with infrastructure being brought onto the asset base currently not generating income. SOE as a whole continued to strain their balance sheets, with net financial liabilities up by R33.5 billion over the period under review, reaching R175.1 billion in 2007/08. Similarly, whilst debt sustainability showed improvement up to 2006/07 reaching 18.3 % as a positive spin-off of the restructuring programmes that the SOE undertook, debt sustainability declined to 14.1% in 2007/08 as the SOE embarked on the infrastructure build programmes in earnest.

2. MACRO-ECONOMIC REVIEW

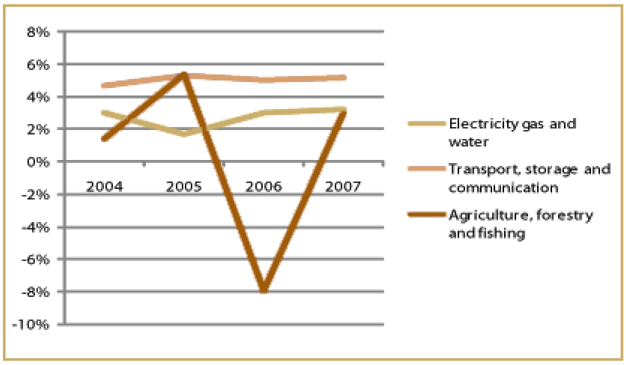
SOE are important participants in the local economy and are active in international markets for the sourcing of capital equipment, finance and partners. Global drivers of economic output impact directly on the performance of SOE and it is therefore critical for the DPE to understand the manner in which SOE manage their performance in this environment.

The world has experienced five consecutive years of strong growth, approaching 5% in 2006/07. This represents one of the longest periods of economic expansion since the Second World War. However, 2007/08 presented significant challenges to economic policy makers in most parts of the world as inflationary pressures intensified, while simultaneously the strong global growth of the preceding four years started to peter out. Matters were further complicated by the turmoil in the developed financial markets related to the imposition of sub-prime mortgage lending in the United States and dislocations in the structured credit markets. Not only did risk premiums rise considerably from previously very low levels, but liquidity in the interbank markets suffered as confidence in counterparties deteriorated. The global economy is expected to slow-down from 4.9% to 3.9% during 2008, mainly due to the slow in the United States.

The South African economy has been growing for eight consecutive years, driven by domestic demand as well as both private and public fixed investment. Economic growth retained robust momentum throughout 2007. Following this strong performance, the South African economy is expected to slow to 3.9% during 2008 as a result of the downturn in global growth, the impact of financial turbulence, increased energy prices, a downturn in local consumer demand and a likely deceleration in capital formation. Capacity problems with the generation and transmission of electricity were experienced in early 2008 and this hampered production in electricity-intensive sectors such as mining and manufacturing, culminating in a slower rate of economic growth during that period. Following four years of robust economic growth fluctuating around 5% per annum, real economic activity expanded at a notably slower pace in the first half of 2008. The moderation in growth to below the country's estimated potential rate of output growth could mainly be attributed to electricity supply constraints in an environment of softening global and domestic demand. Despite tightening economic conditions, real gross fixed capital formation continued expanding robustly in 2007/08. This buoyancy was fairly widespread across the various institutional and economic sectors, and partly reflected the drive to improve South Africa's infrastructure.



Historical trends in the South African economy



Historical growth rates of specific sectors of the South African economy

The DPE seeks to impact positively on the areas of the economy that are within its remit and to understand how SOE can be strategically deployed to support this goal. To this end it is concerned with assisting SOE to enhance South Africa's competitiveness and underpin the objectives of the developmental state by:

- Mitigating the impact of foreign exchange transactions (e.g. equipment purchases) on the balance of payments,
- Supporting the development of infrastructure,
- Supplier development programmes that enhance the industrial and commercial base of the country,
- Human resource and skills development and
- Research and development.

3. COMPARATIVE PERFORMANCE OF SOE

The performance of the SOE has been driven by the realities of the sectors in which they operate and by the strategic positioning adopted. As a portfolio, they are at different stages of maturity and need to be analysed individually. The table below illustrates the SOE financial performance over the period of review.

R MILLION	2003/4	2004/5	2005/6	2006/7	2007/08
ALEXKOR					
Revenue	264.7	152.4	154.8	109.3	139.8
EBIT	31.8	1.5	(209.7)	(9.8)	5.9
Net profit / (loss)	35.7	(6.0)	(205.5)	(19.1)	(4.8)
BROADBAND INFRACO					
Revenue	-	-	-	0	112.0
EBIT	-	-	-	(3.6)	18.0
Net profit / (loss)	-	-	-	(2.7)	40.0
DENEL					
Revenue	4 442.2	3 572.1	2 773.1	3 268.1	3 818.1
EBIT	62.2	(1 314.7)	(1 076.3)	(386.8)	(232.7)
Net profit / (loss)	(377.5)	(1 560.7)	(1 363.4)	(549.1)	(347.2)
ESKOM[1]					
Revenue	32 948.0	43 207.0	36 052.0	40 068.0	44 448.0
EBIT	10 842.0	13 209.0	9 994.0	10 200.0	6 832.0
Net profit / (loss)	3 417.0	5 411.0	4 641.0	6 476.0	974.0
SAA					
Revenue	16 339.0	17 186.0	19 128.0	20 524.0	22 257.0
EBIT	(3 643.0)	581.0	395.0	(650.0)	(1 372.0)
Net profit / (loss)	(8 620.0)	648.0	65.0	(883.0)	(1 085.0)
SAFCOL					
Revenue	682.0	640.7	326.7	653.4	832.2
EBIT	64.8	312.1	211.1	1 044.3	796.2
Net profit / (loss)	(7.1)	202.7	138.7	800.6	638.5
TRANSNET[2]					
Revenue	43 637.0	25 260.0	26 034.0	26 899.0	30 091.0
EBIT	4 750.0	5 414.0	8 138.0	8 200.0	9 387.0
Net profit / (loss)	(6 322.0)	6 564.0	4 930.0	7 136.0	4 311.0

[1] *The results for 2004/5 represent a period of 15 months as during this period the financial year-end of the company was changed for 31 December to 31 March.*
[2] *The results for 2003/4 include SAA financials*

The performance of the SOE to date has been driven by variance in legacy inheritances, enterprise-level strategies, and the underlying industry drivers of their respective sectors. The SOE vary in maturity and need to be analysed individually. Certain of the SOE while in the early stages of improving their operating performance through restructuring remain loss making and continue to be undercapitalised with weak financial positions. Rapid and substantial capital investment programmes in order to meet South Africa's infrastructure requirements to support growth tend to consume cash faster than it can be generated through retaining earnings and borrowing may put some strain on the SOE balance sheet. Legacy or contingent liabilities burden certain SOE in respect of products supplied or capital equipment utilised for the provision of services. Lastly, the regulatory imposition of pricing constraints restricts or will restrict profitability required to fund the infrastructure programmes.

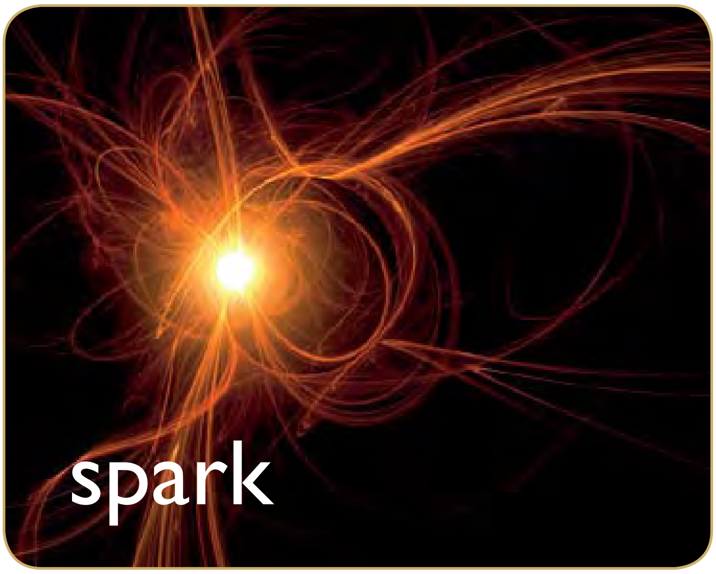
These factors affected the financial condition and performance of the seven main SOE coming under the purview of the DPE. Whilst their revenue increased by over 11% in 2007/08 relative to 2006/07, with all SOE contributing, profit for the portfolio fell by 66% to R4.4 billion. Their aggregate profitability, measuring net income as a percentage of revenue dropped to 4% (2006/07: 14%); similarly, their operating margin and operating profit reduced. Meanwhile, these enterprises as a whole continued to strain their balance sheets, with net financial liabilities up by about R23.3 billion. Portfolio assets increased by 22% with asset growth recorded across all SOE while portfolio equity grew by 23%. As a result of this increase in equity, portfolio leverage improved to 1.33 in 2007/08 from 1.35 the previous year.

4. PERFORMANCE OF INDIVIDUAL SOE

4.1 ESKOM HOLDINGS

ESKOM IN PERSPECTIVE

Eskom is one of the top thirteen utilities in the world by generation capacity and is among the top nine by sales. Eskom generates approximately 95% of the electricity used



in South Africa and 45% of the electricity used in Africa. Electricity generation is primarily coal-fired, but also includes a nuclear power station, gas turbine facilities, conventional hydroelectric plants, and hydroelectric pumped-storage stations. Eskom's total assets increased by R71 682 million over the 5 years under review, from R99 499 million (2003/04) to R171 181 million (2007/08). In general, net profit declined by R2 443 million over the five-year period from R3 417 million (2003/04) to R974 million (2007/08) after showing an increasing trend over the four-year period prior to the 2007/08 financial year. Cashflow from operating activities generated declined by R5 796 million over the five year period from R13 451 million (2003/04) to R7 655 million (2007/08) while capital expenditure increased by R15 867 million from R8 897 million (2003/04) to R24 764 million (2007/08). Electricity sales growth in general decreased from 5% (2003/04) to 2.9% (2007/08). The current nominal generation capacity installed is 43 037 megawatts (MW) with a net maximum capacity of 38 744 MW.

In recent years Eskom's reserve margins have declined and the currently available generating capacity is no longer sufficient to meet the demand for electricity. Power stations have been stretched to run at full capacity, and at certain times, beyond design capacity, resulting in a high number of unplanned outages and a more complex and time-consuming maintenance regime. This lack of reserve margin has contributed to the need for load-shedding when supply is inadequate to meet demand. High rainfalls and lower coal stockpile levels than planned also served to restrict electricity production even further. The financial performance of Eskom has been affected by the dramatic increase in the cost of primary energy, primarily that of coal and diesel which is impacted by the need to use peaking plant to meet base-load requirements when no other generating plant is available.

Over the next five years, Eskom is embarking on the new build programme for capacity expansion and will spend R343 billion in nominal terms. In terms of the revised plan, Eskom will deliver an additional 16 304 MW into the grid by 2017. Of this, 4 644 MW will be available in the next five calendar years (2008 – 2012). This includes the return to service of Grootvlei, Camden and Komati power stations, the commissioning of two open-cycle gas turbines, the upgrade of Arnot and the first units of Medupi and Ingula power stations coming on stream in 2012/13. Of the capital budget, 73% will be spent on generation, 13% on transmission and the remainder will be used to strengthen the distribution networks. An additional capacity of 2 582 MW was commissioned in 2007 by the opening of Ankerlig and Gourikwa power stations. Over the five-year period, Eskom's national electrification programme has electrified a total of 768 205 households.

In order to strengthen Eskom's balance sheet to support the build programme, the Government will provide a subordinated R60 billion loan to Eskom over the next three years.

Eskom is currently busy with the process of attracting independent power producers (IPP). There are three IPP processes in progress:

1. Pilot National Co-generation Programme
2. Medium Term Power Purchase Programme
3. Multi-site Base-load IPP Programme

No contracts have been signed yet, although procurement is in varying stages of progress for each of them.

In terms of skills for the build programme, Eskom's additional internal requirements are approximately 2 500 additional engineers, and 3 900 technicians and artisans by 2012.

Eskom is also in the middle of a process of accelerating its production of skills to 400 artisans per annum, 500 technologists and technicians per annum, and 500 engineers per annum.

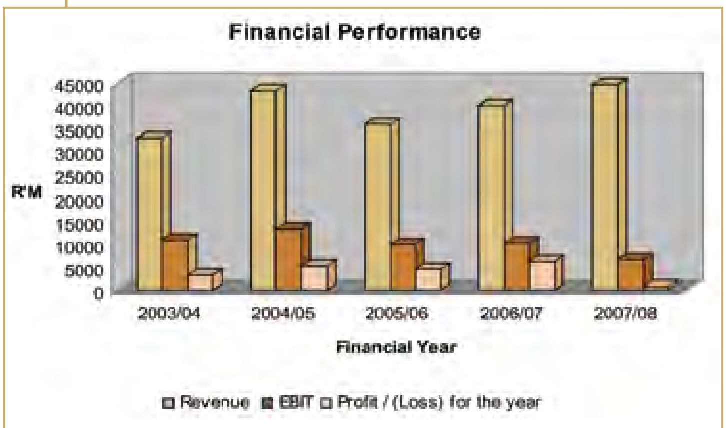
Through the South Africa Power Project, Eskom has also estimated the skills required in its supply industries for the build programme: 3 000 engineers and 24 000 artisans. These demand estimates have been provided to the Joint Initiative on Primary Skills Acquisition (JIPSA), and have informed recent initiatives by the Departments of Labour and Education to increase the annual output of engineers and artisans. For example, the Sector Education and Training Authority (SETA) has recently markedly increased the funding of artisan learnerships and apprenticeships.

FINANCIAL PERFORMANCE

Income statement

R MILLION	2003/04	2004/05*	2005/06	2006/07	2007/08
Revenue	32 948	43 207	36 052	40 068	44 448
EBITDA	15 610	19 010	14 623	14 713	11 562
EBIT	10 842	13 209	9 994	10 200	6 832
Profit/(Loss) for the year from continuing operations	3 417	5 411	4 525	6 938	1 519
Profit/(Loss) for the year	3 417	5 411	4 641	6 476	974

* 2004/05 Financial year represents a 15-month period.



Revenue has shown a steady increase for the period under review with revenue for 2007/08 up by 11% over the previous year. The noted increase in the period 2004/05 above represents a period of 15 months. Annualised revenue for 2004/05 amounted to R34.5 billion assuming that revenue was earned evenly throughout the year, which means that the comparative figure for 2005/06 was an approximate 5% increase.

EBIT showed a fluctuating trend due to provisions, fair value adjustments and embedded derivatives movements. For 2007/08, EBIT declined to R6 832 million from R10 200 in the previous year due to significant increase in primary energy costs from R13 040 million to R18 314 million. EBITDA also showed a fluctuating trend, almost similar to the EBIT and the difference was the result of adjusting EBIT for depreciation and amortisation. The changes in the depreciation and amortisation in 2007/08 were not significant compared to the previous year.

Net profit was erratic over the five-year period ending 31 March 2008, but in general declined from R3.5 billion to R974 million over the five-year period due to increases in primary energy costs incurred and losses due to embedded derivatives. This was despite the fact that revenue increased from R33 billion to R44.5 billion over the five-year period. The increase in revenue achieved has been mainly due to increases in volumes produced and distributed rather than to tariff increases.

Profit decreased by approximately 78% for 2007/08. This was the result of primary energy costs incurred during the winter season when Open Cycle Gas Turbines peaking plants were used to maintain the reserve margin. Included in the profit was a loss of R143 million for 2007/08 relating to an embedded derivative - an accounting entry due to changes in the exchange rates and changes in spot prices of commodities e.g. aluminium prices. Eskom has entered into a number of agreements to supply electricity intensive industries where the revenue from these prices is based on foreign currency rates (mainly US Dollar), commodities (e.g. aluminium) or foreign production price indices. The contracts are fair valued by taking into account the ruling prices and the expected forward electricity curve, which is based on tariffs indicated by the National Energy Regulator of South Africa (NERSA).

Cashflow from operating activities fluctuated over the period under review and in general decreased from R13.5 billion to R5.8 billion, due to the increase in payments for the primary

Balance Sheet

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Non-current assets	70 997	74 105	92 477	109 439	123 534
Current assets	25 995	35 100	35 809	33 873	47 647
Equity	40 683	44 867	50 371	58 357	64 738
Non-current liabilities	32 892	41 722	49 959	62 655	74 749
Current liabilities	23 417	22 616	27 956	22 300	31 694

The increasing trend in total assets is explained by the increase in both equity and total liabilities. Total assets for 2007/08 were R171 181 million, comprising equity of R64 738 million and total liabilities of R106 443 million. There was a notable increase from 2003/04 to 2007/08 in the total assets and this increase is expected to continue for the duration of the build programme.

The non-current assets increased by R52.5 billion over the five-year period under review due to gradual phasing in of the build programme and work in progress. This is evidently so due to the increase in both non-current liabilities and equity of R42 billion and R24 billion respectively. The notable increases from 2003/04 to 2007/08 are expected to continue for the duration of the build programme.

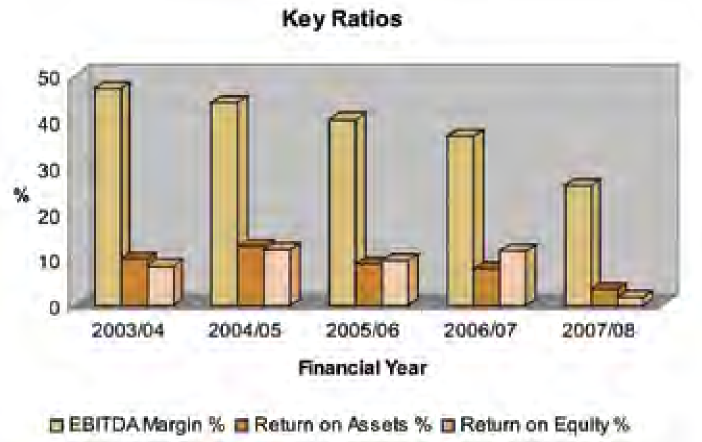
energy cost. Expenditure on infrastructure investments increased by approximately R21 billion over the period and is expected to increase further due to the build programme. Cashflows from financing activities showed an increase in debt raised to finance the capital expansion programme.

Cashflow statement

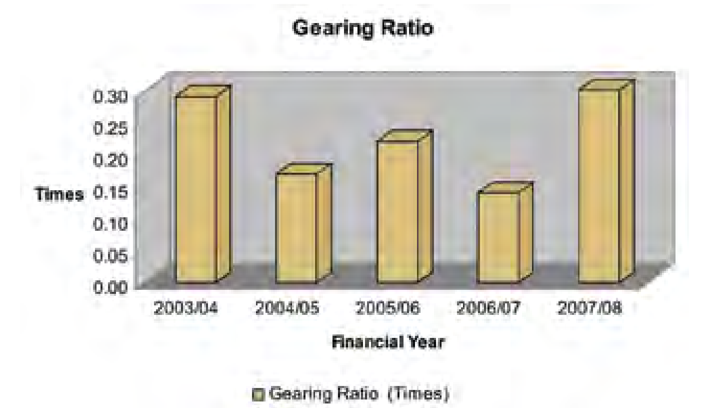
R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Cashflow from operating activities	13 451	15 302	12 346	13 954	7 655
Cashflow from investing activities	(3 311)	(5 345)	(9 003)	(16 908)	(24 322)
Cashflow from financing activities	(11 915)	(8 873)	(1 368)	2 267	18 018
(Decrease)/Increase in cash and cash equivalents	(1 775)	1 084	1 975	(687)	1 351
Cash at the end of the period	7 170	8 254	10 229	9 542	10 893

Key ratios

	2003/04	2004/05	2005/06	2006/07	2007/08
EBITDA margin %	47.4	44.0	40.5	36.7	26.0
Return on assets %	9.97	12.74	9.06	7.83	3.32
Return on equity %	8.48	12.05	9.54	11.91	1.58
Gearing ratio (Times)	0.29	0.17	0.22	0.14	0.30
Cash interest cover (Times)	4.30	5.50	3.76	3.03	1.58



The EBITDA margin percentage showed a declining trend, 21.40% decline over the five years, and this was evident from the electricity prices increasing below inflation. This might prove good ground for Eskom to request further electricity price hikes. Return on Assets decreased by 6.65% over the five-year period and stands at 3.32 due to the infrastructure being brought on the asset base as work in progress, currently not generating income as well as operating income decreasing mainly due to increase in primary energy cost and low electricity price. Return on Equity decreased by 6.9% over the five-year period and stood at 1.58% for 2007/08. This was a result of the decline in profit for the year compared to the previous years.



The gearing ratio has fluctuated but has shown a steady increase during the past two years and decreased considerably in 2007/08 due to additional borrowings for the build programme. Cash interest cover times which show a declining trend, have decreased by 2.72% over the five- year period; this is the result of the gradual increase in borrowings to fund the build programme

Capital expenditure

Expenditure indicators

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Capital expenditure	6 241	8 999	10 867	17 707	24 764

Eskom has spent R24.7 billion on capacity expansion to date, an increase of R18.5 billion over the five years. It plans to gradually invest R343 billion in capacity expansion projects over the next five years. Of this amount, approximately 73% will be spent on electricity generation, with the remainder split mainly between distribution infrastructure and the transmission network. Up to R150 billion of the overall amount will be funded by raising debt on local and international markets.

OPERATIONAL PERFORMANCE

Volume Growth %

2003/04	2004/05	2005/06	2006/07	2007/08
5.0	30.5	(18.9)	4.9	2.9

The volume growth showed an average of 5% increasing trend over the four year period 2003/04 to 2006/07, after normalising during the 2004/05 financial year (15 months to 12 months). Volume decreased by 2% from 2006/07 to 2007/08. Considering that the 2004 financial year had 15 months reporting versus the 12 months of 2005/06, comparing like with like 2003 versus 2004 growth was 5.0% and 5.1% respectively. Comparing 2006/07 with 2005/06, growth was 4.9% and 0.8% respectively. Growth in 2006/07 was due to a colder winter, while the increase in sales was due to higher commodity prices.

Productivity Improvement %

2003/04	2004/05	2005/06	2006/07	2007/08
2.5	1.8	(2.1)	1.90	(9.0)

The productivity change percentages indicate the relationship of output changes and all input changes year-on-year. The numbers reflect the extent of wealth added or eroded by the business from all resources (primary energy, human resources, other operating expenses and capital [depreciation; interest and finance charges]). It reflects therefore the marginal change in wealth-making.

Over the last five years the annual productivity changes reported in the annual report showed a downward trend from positive (2.5%) in 2003 to negative (9%) in 2007/08. This trend is symptomatic of the growing quantity of operational resources needed in relation to the annual change in sales growth of the company. The 2005/06 and 2007/08 financial years showed productivity decline while the other years have shown improvements. The 2007/08 financial year showed the highest productivity decline largely due to the increased use of diesel powered generators in dealing with the generation capacity shortfall to meet electricity demand. The significance of this is that in the past Eskom was able to combat price under recovery through productivity improvement, but with the capacity constraints experienced now and expected for the foreseeable future this has become impossible.

Value created per employee (R)

2003/04	2004/05	2005/06	2006/07	2007/08
578	808	679	775	454

The annual value created per employee has been increasing from 2003/04 until 2006/07. In general, it increased by R197 and decreased by R321 in the 2007/08 financial year. The 2004/05 financial year was a 15 months period and the normalised value created per employee was R646. The decrease in 2007/08 was due to lower profits and an increase in employee numbers.

Safety Index

2003/04	2004/05	2005/06	2006/07	2007/08
0.37	0.45	0.40	0.35	0.34

The improvement in the safety index over the past five years has been due to the increased leadership visibility, lessons from previous incidents, increased training of staff, introduction of specific protective clothing and tools to reduce high-risk incidences, senior management safety walkabouts and more extensive reporting.

SOCIO-ECONOMIC PERFORMANCE

Supplier development

Eskom is participating in the competitive supplier development programme (CSDP) and has submitted a five-year supplier development plan (SDP) to the Minister of Public Enterprises. This is currently waiting for approval. Eskom has also participated in the South Africa Power Project (TSAPRO) which is similar to, but broader than the CSDP.

The SDP describes targets which Eskom has set itself for increasing the local content of selected components of its supply chain over the next five years.

Employment Equity %

2003/04	2004/05	2005/06	2006/07	2007/08
56.3	57.9	60.10	63	66.40

Eskom continues to be a leader in driving employment equity, which has enabled it to achieve a staff complement that reflects the South African diversity. In general there is an increase of 10.1 % over the five-year period under review.

Training cost (R million)

2003/04	2004/05	2005/06	2006/07	2007/08
505	518	543	748	784

Eskom continued to make the necessary human resources investment by spending R3 098 million on training over the past five years. Eskom views training as one of the strategic key area in the business. Over the past five years there has been an increase of R279 million in training costs, from R505 million in 2003/04 to R784 million in 2007/08.

Disabilities %

2003/04	2004/05	2005/06	2006/07	2007/08
1.4	2.00	2.50	2.80	3.30

Eskom is committed to employing people living with disabilities and this is shown by the increase of 1.9% over the period under review. This is in line with Government's objective of employing people with disabilities.

Gender Equity

2003/04	2004/05	2005/06	2006/07	2007/8
27.8	28.90	31.80	33.30	34.80

Eskom is driving gender equity, and continues to focus on the promotion of women. The gender equity shows an increasing trend with 7% increase over the five year under review. This shows the effect of Eskom's policy on gender equity and also contributes to the Government's objective on gender equity.

Capital Investment Programmes

Additional power stations, major power lines and substations are being constructed urgently to meet rising electricity demand in South Africa. The capacity expansion plan is R343 billion up to 2013 and is expected to grow to more than a trillion rand by 2026. Ultimately Eskom will double its capacity to 80 000 MW by 2026. The budget approved by Eskom's board and shareholders is designed to meet the challenges of electricity reliability and availability and is aligned with Government's target of 6% GDP growth between 2010 and 2014.

Economic impact

Eskom has recently submitted a draft competitive supplier development plan for the next period. The plan identifies five priority areas for development, namely structural steel, coal turbine, coal boiler, transmission equipment and controls and instrumentation. The plan aims to increase local spend on 5 priority focus groups by 22%, thereby impacting SA balance of payments by at least R13.5 billion.

Research and Development

The Eskom research and innovation department provides scientific and technical advice, research and consulting, analysis, detailed design as well as strategic technical planning services and direction. The actual research expenditure in 2007/08 was R156 million (2006/07:R203 million) while the expenditure on demonstration plants amounted to R93 million in 2007/08 compared to R121 million the previous year.

4.2 PEBBLE BED MODULAR REACTOR (PBMR)

PBMR IN PERSPECTIVE

Pebble Bed Modular Reactor (Pty) Ltd (PBMR) is a joint venture between the South African Government, Eskom, the

Industrial Development Corporation and a global nuclear company, Westinghouse. It was established to pioneer small, standardised, inherently safe, modular reactors as one of the best carbon-free alternatives for new power-generation and process heat applications around the world. This SOE is still in project delivery stage and as such requires net investment and support from the joint venture participants. A total of R6.1 billion has been invested in PBMR by the joint venture participants to date and the Government has allocated a further R6 billion over a three- year period up to fiscal year 2009/10 to the project through the Medium Term Expenditure Framework.

PBMR was established in 1999 and has grown into the largest nuclear reactor design team for intermediate and high temperature gas reactors and fuel supporting Generation IV objectives. In addition to the core team of some 800 people at PBMR, more than a thousand people at universities, private companies, and research institutes are involved with the project. The PBMR team is currently preparing for the construction of a commercial-scale power reactor at Koeberg and a fuel plant at Pelindaba near Pretoria. The current schedule is to start construction in 2010 and for the first fuel to be loaded four years later. Long-led manufacturing items are in procurement. It is likely that a process heat plant will be developed in parallel. Construction of the first commercial PBMR modules for power application is planned to start three years after the first fuel has been loaded into the demonstration reactor.

The development and commercialisation of PBMR is planned as follows:

- Core Project Focus: Design and construction of the demonstration power plant at Koeberg and the associated PBMR fuel plant at Pelindaba
- Market Development: Development of the Process Heat Market in South Africa and North America
- Commercialisation: focused on the supply of 24 plants to Eskom from 2016 onwards; construction of a commercial fuel plant at Pelindaba; export of plants to international markets and the development and supply of pebble bed reactors for process heat applications from 2017.

FINANCIAL PERFORMANCE

Income statement

R MILLION	31/12/2003	2004/05[3]	2005/06	2006/07	2007/08
Revenue	-	-	-	1.8	1
Cost of sales				(1.6)	(0.9)
Gross surplus				0.2	0.1
Capital contributions and other income		478.8	15.3	1 398.3	1 960.7
Operational and finance expenditure	-	478.8	(14.1)	(1 319.3)	(1 865.7)
Surplus for the year	-	-	1.2	79.1	95.1

At present, PBMR is not yet a commercially viable entity, being primarily concerned with the development and construction of the PBMR fuel plant and a demonstration power plant. Comparative assessment of profitability using the criteria applied to other SOE is therefore not appropriate. Instead, the company should be evaluated on a project maturity basis as a technology option in the hands of Government given the intention to capture nuclear manufacturing and engineering capabilities for South Africa.

As of 31 March 2007, a total of R3.8 billion had been invested in PBMR. The Government has allocated R6 billion to the project until 31 March 2010 through the Medium Term Expenditure Framework.

[3] *Amounts are for the 15-month period (1 January 2004 to 31 March 2005) - switchover from calendar year-end to 31 March year-end.*

During 2006/07, PBMR received R1.3 billion (2005/06: R874 million) from contributing parties, the bulk of which was spent on research and development. The company had an operating deficit of approximately R16.7 million (2006/07: Nil). This was offset by finance income of R23.6 million (2005/06: R15.3 million) and a net foreign exchange profit of R72 million (2005/06: R13.5 million loss) to generate a surplus for the year of approximately R79 million (2005/06: R1.19 million). As at 31 March 2008, PBMR had received R6.7 billion in contributions from investors, which included VAT of R526 million. Of the total amount, Government had contributed R4.360 billion or 72.8%.

There are a number of contingent liabilities that need to be supported by the Government in relation to PBMR to secure a positive investor climate and ensure supplier commitment. These include the need to provide for a nuclear indemnity fund, guarantees for premature decommissioning costs and the risk of exposure to fair value accounting adjustments to account for the cost of foreign manufactured equipment.

Balance Sheet

R MILLION	31/12/2003	2004/05	2005/06	2006/07	2007/08
Non-current Assets	-	-	11.3	31.5	62.7
Current assets	130.2	351.1	422.1	263.2	956.7
Equity	-	0.4	1.6	80.7	175.7
Non-current liabilities	0.3	0.3	7.4	11	111
Current liabilities	129.9	350.4	424. 4	203. 1	732.7

Cashflow statement

R MILLION	31/12/2003	2004/05	2005/06	2006/07	2007/08
Cashflow from operating activities	(152.3)	241.5	80.5	37	312.2
Cashflow from investing activities	59.1	(5.5)	4	(8.5)	(11)
Cashflow from financing activities	-	-		(245.4)	364.1
(Decrease) / Increase in cash and cash equivalents	(93.1)	236	84.5	(217)	665.3
Cash at the end of the period	98.2	334.2	418.7	201. 9	867.1

OPERATIONAL PERFORMANCE

Safety Index %

PBMR has achieved the following safety milestones during 2007/08:

- Helium test facility (HTF) - 100 000 man-hours accident-free
- Fuel Development Laboratories (FDL) - 100 000 man-hours accident-free
- Heat Transfer Test Facility (HTTF) –
  - High-pressure test unit at the Potchefstroom campus of the University of North-West: 10 139 total man-hours accident-free.
  - The HTTU on the North-West University site: 8 510 total man-hours accident free.

Supplier development

PBMR competitive supplier development initiatives aim to:

- establish a sustainable, internationally competitive local nuclear industry;
- become a supplier of nuclear components and services to the local and international nuclear market;
- assist in the development of an advanced manufacturing infrastructure and to meet the required international standards;
- maximize skills development, job creation and black economic empowerment (BEE) through the nuclear industry;
- supply high-value goods and services to the local and international markets; and
- promote technology transfer, joint ventures, new trading partners and foreign investment.

Where other reactor-producing countries already have established and sustainable nuclear support industries, South Africa has to develop its emerging local nuclear industry as quickly as possible, to be globally competitive. To encourage the participation of the private sector, markets need to be open and intellectual property must be protected. To enable the local manufacturing of some components of the demonstration power plant (DPP), local companies will need to be accredited in accordance with ASME III standards and codes. Discussions are under way with various stakeholders to ensure that the certification of the companies is done within the required timescales. Five South African companies are in the process of achieving ASME III accreditation to be able to manufacture demonstration power plant components.

SOCIO-ECONOMIC PERFORMANCE

BBB/EE Rating

PBMR has conducted a review of its current broad-based black economic empowerment (BBBEE) status in line with the gazetted Codes of Good Practice. Although the evaluation was not a detailed auditing exercise, an independent consultant was used to give an estimate of where PBMR currently stands in terms of BBBEE. The company is currently a Level 6 contributor. PBMR has set a target to be a Level 3 contributor by 2010. A formal strategy is being developed to achieve this target.

Employment Equity Index

The table below depicts PBMR's current employment equity status. PBMR recognises the need to further improve on these numbers and has been developing strategies to address this. Appropriate targets will be set and reported on.

EE Category	Current as at end March 2008
Black	39%
White	61%
Male	70%
Female	30%

Training Index

PBMR's internal training initiatives are focused on providing each employee with the best knowledge and skills to perform at a world-class level. The company also aims to provide employees with the necessary opportunities for self-development and growth. Succession management and mentoring are promoted through PBMR's senior management level development initiatives.

PBMR has developed an Accelerated Development Programme for high-potential/high-performing employees in technical skills categories linked to business requirements. This initiative has Executive Management and Board approval, and is closely linked to the Employment Equity Plan and strategies. It started in January 2008. This programme will mainly focus on critical technical positions within the business and create the mechanism to build capacity from within PBMR's business in critical areas.

Formal training

PBMR has been registered with the Energy Skills Education Training Authority (ESETA) for the past five years, and has submitted its workplace skills plan to the SETA every year, as required. Induction and orientation training is conducted on a regular basis. Safety culture and safety training form an integral part of PBMR's training and development initiatives. Formal training includes leadership development, natural work teams and project management within PBMR. The focus in 2007 has been on the training of PBMR employees in the company's procedures and processes to ensure that employees have the required understanding of PBMR's business processes.

PBMR has developed an Engineering Council of South Africa (ECSA) Mentorship Programme, which is now integrated into its normal training, and is equipped with additional information regarding the importance of continued professional development. Teambuilding sessions have been scheduled as a way of introducing mentor and mentee teams to each other through fun activities. PBMR supports the development of personal development plans linked to individual performance compacts for employees who require development. PBMR has embarked upon a national capacity-building initiative to establish, implement and maintain the necessary strategies, systems and processes required for the proactive and focused development of PBMR's core and support competencies. The aim of this initiative is to ensure the sustainability of capacity within PBMR and the nuclear industry in order to be internationally competitive.

Further studies

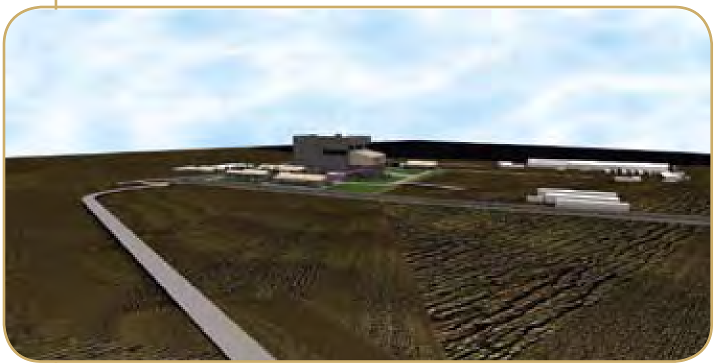
PBMR sponsors a further study scholarship programme. This enables employees to study further to improve their knowledge, based on management approval, and in the interest of both the individuals and PBMR. These studies can be undertaken on a part-time, full-time or correspondence study basis. This scheme enables PBMR employees to improve their knowledge for their own benefit and that of PBMR, by obtaining qualifications that are nationally recognized. This scheme is currently well-supported and is proving to be a very cost-effective and useful mechanism to build capacity and motivate employees.

PBMR scholarship students

PBMR is currently sponsoring 33 undergraduates at seven South African universities on eight campuses, studying in different PBMR-related disciplines. In addition to the undergraduate scholarships, PBMR is also sponsoring:

- Five PhD students. Three are studying at local universities, and two abroad;

- Eight master's degree students at the North-West University, Mafikeng campus, studying for a master's degree in Applied Radiation Science and Technology (MARST);
- Two master's degree students at Carbon Laboratory at the University of Pretoria. The focus is on waste minimisation;
- One scholarship at the North-West University for a student to complete a master's degree in Nuclear Engineering;
- Seventeen PBMR employees who are registered at the Potchefstroom campus of the North-West University, on a part-time basis, to complete selected modules and complete master's degrees in Nuclear Engineering.



Collaboration with universities

PBMR sponsors bursaries for students who study at universities and are participating in PBMR-related R&D projects linked to the PBMR Technology Plan. Two PBMR employees are currently undertaking PhD studies on Nuclear Waste Management, with R&D students involved in other research projects at Stellenbosch, Nelson Mandela Metropolitan and North-West universities.

International collaboration

PBMR contracted Professor Kostadin Ivanov from the Pennsylvania State University for a four-week period during July/August 2007 to run a series of lectures for staff. The main aim of the visit was to build capacity in the areas of uncertainty treatment, kinetics and dynamics and to work together with PBMR employees on projects in the area of core neutronics and thermal hydraulics. PBMR sponsored two employees to attend the World Nuclear University's (WNU) third Annual Summer Institute, from 14 July 2007 to 24 August 2007, in Daejoen, Korea. It was designed to develop and inspire future international leaders in the realm of nuclear science and technology.

Millennium School of Particle Physics

The Millennium School takes place every two years to promote the nuclear, particle and radiation physics specialist group of the South African Institute of Physics. This initiative is hosted by iThemba Labs and the purpose is to attract as many students, from the third (completed) year to PhD level of study, from all the South African universities. The aim is to promote the teaching of nuclear and particle physics, as well as providing exposure to nuclear science, by combining teaching resources throughout South Africa in a stimulated and mentoring environment. Preference is given to previously disadvantaged students. PBMR, in conjunction with other nuclear industry stakeholders supports this programme.

Centre of Applied Radiation Science and Technology (CARST)

The Masters in Applied Radiation Science and Technology (MARST), which is a project managed by the CARST at the North-West University (Mafikeng campus), is supported by PBMR and has successfully resulted in a number of staff appointments being made from graduate students from this programme. Every year PBMR supports four first-year and four second-year students through this programme. On successful completion of this programme, students graduate with a master's degree in Applied Radiation Science and Technology from the North-West University (Mafikeng campus). PBMR has also been actively involved in the revision of this curriculum and course content and has assisted in the preparation of the business plan for the establishment of a laboratory at the Centre of Applied Radiation Science and Technology. Construction work on these laboratories has now started.

Accelerated development programmes

Apart from developing and growing its employees, PBMR supports South Africa's capacity building programmes. The purpose of the national capacity building initiative within PBMR is to establish, implement and maintain strategies, systems and processes required for the proactive and focused development of PBMR's core and support competencies. The aim is to ensure the sustainability of capacity within PBMR and the nuclear industry, in order to be internationally competitive. PBMR is supportive of both the Accelerated and Shared Growth Initiative for South Africa (ASGISA) and The Joint Initiative on Priority Skills Acquisition initiatives and is working with other SOE to identify skills requirements in the priority skills categories both from within these organisations, as well as the skills requirements from the contractors during the build phase of the demonstration power plant and fuel plant. These initiatives will allow for the provision of the necessary skills planning at a macro level. PBMR has already initiated a skills pipeline to meet these targets. PBMR is also working very closely with the DPE to establish an Employment

Skills Development Agency (ESDA) to facilitate the training of people in these priority skills categories. To fully understand the skills requirements for the industry, input was obtained from the major stakeholders that currently operate in the industry, namely Nuclear Energy Corporation of South Africa (NECSA), PBMR, Eskom and the National Nuclear Regulator (NNR). Although the current focus is on bridging short-term skills gaps through identified and agreed skills programmes (for the purpose of this business plan), it is envisaged that future training leading to full qualifications will be incorporated into future programmes to address the issues surrounding long-term capacity building. A total of €1.5 million has been raised and training of all the member organisations is currently taking place. South African Nuclear Human Asset Research Programme (SANHARP) represents a significant development for South Africa in the field of nuclear science and technology.

Preferential Procurement Index

PBMR's aims are to achieve a target of 50% of measured value to be spent on black owned suppliers.

Succession Planning Index

A succession management procedure has been approved. The implementation of this procedure has commenced with the identification of critical/scarce skills within the business. The next steps will be to identify possible successors for critical/scarce positions, and these employees will be developed accordingly. Talented, high performing black employees will be given preference in filling these vacancies.

Economic impact

An economic impact assessment was last performed in 2006. PBMR is in the process of conducting a revised study given the current state of the nuclear industry – with Eskom who has announced that new conventional nuclear plant capacity will be installed between 2008 and 2025, complementary to its qualified commitment to purchase 24 PBMR units. In parallel to the Eskom announcement, the DPE, together with SOE, put in place a Competitive and supplier development Programme (CSDP) to increase the competitive capacity and capability of the South African nuclear supplier base. The South African Power Project (TSAPRO) was also announced, to facilitate the leveraging of new power plant capital expenditure and optimise the South African power industry creation efforts.

The final outcome of TSAPRO will direct the PBMR-specific localisation strategy, and an update of the PBMR-specific social and economic impact will only be useful once the results of TSAPRO, expected by the second quarter of 2008, are available.

Research and Development

Technology development is required to:

- enhance the passive and safety attributes of the pebble bed modular reactor;
- make it environmentally more attractive;
- provide the means to measure the hottest fuel temperature; and
- improve the performance characteristics of the fuel.

PBMR's areas of technology development are focused on improving an excellent design and the following areas of development are currently in progress:

- Nuclear waste minimization.
- Fuel development/improvement.
- Magnetic scrubber.
- Fuel temperature measurement.
- Passive cooling systems.
- Materials improvement.

4.3 BROADBAND INFRACO

BROADBAND INFRACO IN PERSPECTIVE

Broadband Infraco is a State-led intervention to rapidly normalise telecoms market efficiency by commoditising only those parts that impede private sector development and innovation in telecoms services and content offerings. The focus area is characterised by limited competition and significant barriers to entry because of regulatory, rights of way and high capital expenditure considerations. Broadband Infraco will not participate in those areas of the South African telecommunications market that are efficient and experience high levels of competition in terms of available services and pricing options.

The Broadband Infraco intervention comprises two key elements, namely:

- The **National Long Distance** fibre optic network, based on the fibre optic assets deployed by Eskom on power transmission lines and Transnet along railway infrastructure in anticipation of the licensing of the Second Network Operator (now Neotel), and,
- The **International Marine Cable** network comprising a marine cable to be deployed between South Africa and the United Kingdom.

South Africa's lack of investment in undersea cables has not helped in reducing higher telecommunication prices, thus Broadband Infraco - through its Africa West Coast Cable (AWCC) project - aims to influence the prices of telecommunications in South Africa. The core strategy behind the AWCC project is to rapidly broaden the supply base of international marine capacity in South Africa in order to create a naturally competitive free market structure that will quickly drive international bandwidth pricing down.

Broadband Infraco is expected to contribute to the reduction of the international bandwidth prices which will result in lower telecommunications prices in South Africa. For proper broadband at affordable rates, South Africa needs much more backhaul network capacity to serve the potentially very large broadband subscriber base. One of the biggest problems in the local telecoms market is the shortage of transmission network capacity.

During the period under review the company had one customer, namely Neotel (Pty) Ltd. Neotel has officially launched its voice and data service offerings in the South African market by making use of the Broadband Infraco national long-distance network.

At the beginning of 2006/07, the network assets comprised 6 000 km of incomplete fibre optic cable routes. The network was designed to provide connectivity between the major metropolitan centres of the country. These network assets were completed, upgraded and commissioned and long-distance connectivity services were handed over to Neotel.

Broadband Infraco network infrastructure comprises 11 500 kilometres of optical transmission links and 135 long-distance sites. Neotel was awarded the State Information Technology Agency (SITA) contract for the provision of telecommunications services. Broadband Infraco was therefore requested to provide long-distance connectivity to 18 SITA sites nationwide.

Eskom Enterprises received funding of R627 million from the DPE on behalf of Broadband Infraco at the beginning of 2007/08 financial year. This funding was designated for the acquisition of the original long-distance network assets developed by Eskom Enterprises and Transnet. The funds were invested in market linked investments by Eskom Holdings Limited on behalf of Eskom Enterprises and Broadband Infraco and earned interest totalling R61.4 million during the year.

With regard to corporate governance, Broadband Infraco is a new start-up entity so it does not yet have fully developed business processes, organisational controls and governance practices of its own. During the current and previous financial years, the company applied the Eskom Enterprises corporate governance processes to its business activities, most notably in the areas of procurement and financial controls.

Net profit after tax during 2007/08 was R40.783 million, an improvement from the net loss of R2.781 million made in the 2006/07 financial year. Revenue earned during 2007/08 was R112.316 million. There was no revenue earned in the previous financial year. Revenue earned includes an amount of R54.300 million which is an accrual recognized on the straight-line of operating lease income over the period of the lease agreement. Cost of sales and operating expenses were R93.659 million in 2007/08, an increase from the amount of R3.660 million in 2006/07 financial year.

Broadband Infraco had sufficient funding to meet all of its capital and operating expenditure obligations during 2008. The company showed a net profit of R40.783 million in 2007/08, a significant improvement from the loss of R2.781 million in the first year of operation. The tax paid during the 2007/08 period amounted to R16.657 million compared to R1.136 million paid in the 2006/07 period. No dividends will be paid until Broadband Infraco has a positive cashflow from operations. This is not expected to happen before 2012/13.

FINANCIAL PERFORMANCE

Income statement

R million	2006/07	2007/08
Revenue	0	112
EBIT	(3.6)	18
Profit / (Loss) from continuing operations	(3.6)	18
Profit / (Loss) for the year	(2.7)	40

Included in the revenue is R38 million derived from the "Right of Use and Operated" Agreement with Neotel. The amount of R20 million that forms part of the 2007/08 revenue relates to the recovery of costs incurred by Broadband Infraco.

Operating expenditure in the 2007/08 period increased to R93.7 million compared to R3.7 million in 2006/07. The increase is mainly attributable to the cost of network operations, maintenance and repairs.

The resulting operating loss for 2008 would therefore have been R35.6 million without the revenue accrual of R54.3 million. At the end of the 2006/07 period, the company had accumulated losses of R2.781 million and the company's total liabilities exceeded its assets by R2.781 million.

Broadband Infraco posted an after tax profit of R40.783 million in 2007/08 compared to the loss of R2.781 million in 2006/07, the profit was largely due to the interest income on the funding of R61.4 million. The operating profit for 2007/08 showed an improvement of R18.657 million compared to a loss of R3.660 million made in the first year of operation.

Balance Sheet

R million	2006/07	2007/08
Non-current assets	7	653
Current assets	0.953	686
Equity	(2.7)	665
Non-current liabilities	0	15
Current liabilities	11	660

The difference in equity, from negative R2.7 million in 2007/06 to R665 million in 2008/07, is attributed to the Government's equity contribution, which was used to purchase the assets, hence the increase of non-current and current assets from 2007/06 to 2008/07.

Cashflow statement

R million	2006/07	2007/08
Cashflow from operating activities	(2)	23
Cashflow from investing activities	(6)	2
Cashflow from financing activities	8	2
(Decrease) / Increase in cash and cash equivalents	0	51
Cash at the end of the period	0	51

Cashflows from operating activities for 2007/08 increased to R23.107 million compared to (R1.725 million) in 2006/07. Cashflow at the beginning of the year was R51.019 million and it remained the same at the end of the year. There was no total cashflow at the beginning and end of the 2006/07 financial period.

The performance for 2007/08 reflects a significant improvement from the previous months. The improvements can be attributed to the network architecture improvements implemented in the first quarter of 2008. The overall average availability of the circuits at a customer service level was 98.86%.

Key ratios

	2007/08
Return on Assets %	0.6
Return on Equity %	0.6

Broadband Infraco was operational during 2008 and is awaiting a licence, which is required prior to provisioning of services to the market. During 2007/08 Broadband Infraco was funded 100% by means of equity and did not have any debt funding.

Capital expenditure

R million	2006/07	2007/08
Capital expenditure	6	616

The capital expenditure increase is attributed to the transfer of assets from Eskom Enterprises (Pty) to Broadband Infraco.

OPERATIONAL PERFORMANCE

Productivity Improvement – Turnover: 11.92%

The contract for Broadband Infraco Human Resources policy development and employee recruitment was concluded with Deloitte Consulting on 6 February 2008. The actual number of employees is 13 whereas the budgeted number of employee was 37 with an actual turnover of R112 million and a budgeted turnover of R38 million.

Productivity Improvement - Personnel Cost**:** 131%

The salary packages and performance/short-term incentive scheme levels for permanent employees were approved by the Human Resource and Remuneration Committee on 17 April 2008. As highlighted above, the actual number of employees is 13 whereas the budgeted number of employee was 37 with actual personnel Cost of R12m and Budgeted personnel cost of R26m.

Socio-economic Performance

Given that this was the first full year of business operations for Broadband Infraco, the company has not yet developed a corporate social investment policy but will do so in due course.

BEE Rating

The company supports the concept of Black Economic Empowerment. The company's approach to BEE is based on the perspective that BEE is an economic and business imperative.

During the period under review, procurement of goods and services has been the company's primary focus area in advancing BEE. The company adopted a procurement scorecard which gives due recognition to the BEE initiatives of vendors in terms of the BEE Codes of Good Practice. Broadband Infraco has adopted and implemented the necessary commercial processes to ensure that the company complies with Broad Based Black Economic Empowerment "BBBEE" requirements for the procurement of goods and services for the organisation.

Employment Equity Index

Broadband Infraco is still in the process of recruiting staff, and it aims to comply with the Employment Equity and Affirmative Action practices.

Preferential Procurement Index

Whilst progress has been made during the period under review in the procurement area, Broadband Infraco will continue to refine and advance its BEE Preferential procurement practices in the ensuing years whilst formulating a broader BEE strategy.

Succession Planning Index

The company is committed to creating and maintaining a proper strategic human resource management system that will ensure succession planning.

SAFCOL

4.4 SOUTH AFRICAN FORESTRY COMPANY

SAFCOL IN PERSPECTIVE

SAFCOL is the State-owned forestry company, which has been restructured in order to achieve privatisation objectives. SAFCOL has remaining interests in an operational subsidiary, Komatiland Forests (KLF) and IFLOMA, a Mozambican forestry and plantation business. Komatiland Forests has been earmarked for privatisation. The financial performance of SAFCOL has been driven primarily by strong demand and an increased selling price for timber products, as well as positive revaluation of its plantation assets, resulting in a positive financial position over the review period. The complexities in dealing with land claims and competition concerns will need to be resolved as part of the KLF privatisation process.

In 1997, Cabinet decided that the State should exit from plantation forestry due to the fact that the industry is not regarded as strategically important. To allow restructuring, the commercial plantation forests of SAFCOL and the Department of Water Affairs and Forests (DWAF) were separated into five geographically logical "packages". Each package was established as a separate company and SAFCOL acts as the holding company for the State's equity interests in each subsidiary.

During the period 1999 to 2005, a majority equity stake in four of the five packages, accounting for some 55% of the total forest area, was transferred to private ownership. The remaining package that has not yet been sold includes approximately 130 000 hectares of forests, mainly located in Mpumalanga and Limpopo, held in the SAFCOL subsidiary KLF. In addition to its forests, KLF has a small research and development (R&D) facility, a tree nursery and one operational sawmill. At present, KLF accounts for more than 90% of SAFCOL's responsibilities and sales. KLF plays a relatively small part in the forestry, timber, paper and pulp (FTPP) sector, with a 2.5% economic contribution and a 3.5% contribution to employment. However, SAFCOL supplies approximately 30% of the country's softwood sawlogs and plays a significant role in Mpumalanga and Limpopo where it contributes over 50% of the production of sawlogs.

A transaction which would have transferred majority ownership of KLF was terminated in March 2006, primarily due to Competition Commission concerns. The complexities of dealing with land claims and competition concerns will need to be resolved in the current KLF privatisation process. Land claims have been registered for about 70% of the State forest land used by KLF and any privatisation transaction should recognize and address the expectations of land claimants. These two highly complex issues are being addressed with the relevant stakeholders, with specialist input. The transaction timelines have been adjusted to take the resolution of these issues into account.

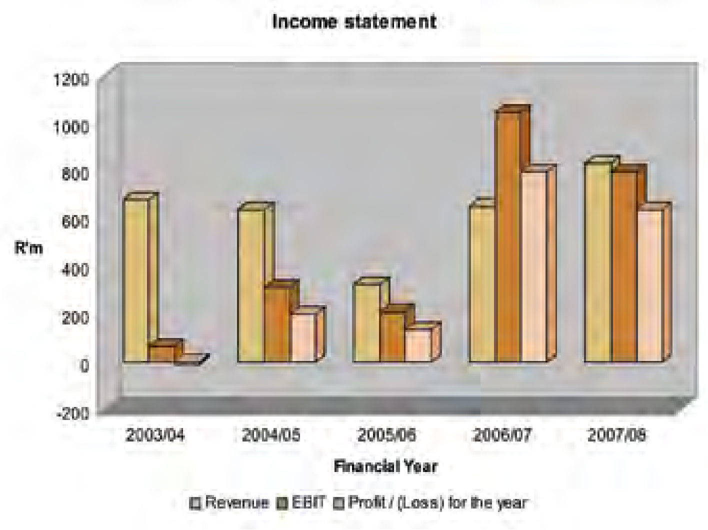
FINANCIAL PERFORMANCE

Income statement

The income statement summarises SAFCOL's income and expenditure over the financial year. The following table highlights the main income and expense items. Revenue largely reflects SAFCOL's sale of timber whereas the EBIT reflects the net (income less expenses) operating income including revenue that SAFCOL can reasonably be expected to generate in the next financial year. It therefore excludes discontinued operations and non operational income/ expenses such as tax, investment income, interest expense and profit from associates. Net Operating income reflects the type of income that would be expected to be generated in the next financial year but not necessarily the value of the income. The value of the income will be influenced by factors such as increasing prices, interest rates and demand as well as other factors specific to the industry, such as fires.

R million	2003/04	2004/05	2005/06*	2006/07	2007/08
Revenue	682.0	640.7	326.7	653.4	832.2
EBIT	64.8	312.1	211.1	1 044.3	796.2
Profit/(Loss) from continuing operations	42.9	232.8	185.9	829.1	641.6
Profit/(Loss) for the year	(7.1)	202.7	138.7	800.6	638.5

*** The 2006 figures reflect a 9-month period due to a change in the financial year-end from 30 June to 31 March. All figures prior to the 2006 financial year have been restated.**



The above table reflects that SAFCOL has experienced an increase in revenue during 2007/08. This increase in revenue is largely attributable to increased selling prices driven by high global demand for timber products especially in the building and construction industry. The perceived decline in turnover and profitability observed in 2005/06 was due to the fact that the 2005/06 financial year reported on a 9-month period.

SAFCOL experienced a significant increase in net operating profit for the financial year ended 31 March 2007. This increase was largely attributable to the R861 million upward revaluation of biological assets. The results for the current financial year ended 31 March 2008 have however been impacted by the fires experienced in July/August 2007. The consequences of the fires were increased expenses and a loss of biological assets. SAFCOL therefore settled on a net profit of R638.5 million, a decline of 20% compared to the prior financial year.

Balance Sheet

While the income statement indicates the results of operations over a certain period of time, the balance sheet provides a financial view of the company at a specific point in time. In this instance the final view is on 31 March 2008. Equity and liabilities reflect the source of capital whereas the asset side of the balance sheet reflects how the capital is used. Current Assets and Current Liabilities are items that are not expected to appear on the balance sheet at the end of the next financial year, 2009. For example, a Current Asset is inventory which will be sold in the next 12 months and a Current Liability is an account which is payable within the next 12 months.

R million	2003/04	2004/05	2005/06*	2006/07	2007/08
Non-current assets	1 006.7	1 202.6	1 396.7	2 274.2	2 911.8
Current assets	258.7	293.0	278.5	495.2	716.8
Equity	908.6	1 113.1	1 249.6	2 047.4	2 695
Non-current liabilities	191.2	245.1	319.4	592.0	751.3
Current liabilities	165.6	137.4	106.2	130.1	182.3

SAFCOL has a strong balance sheet, with satisfactory liquidity and solvency positions. This is due to the profitability of the business and very minimal use of external financing. SAFCOL's non current assets have increased by 189% over the five-year period under review largely due to the plantation valuation adjustments performed annually. As at 31 March 2008, SAFCOL had a year-on-year increase of 44.7% in current assets. This increase is as a result of the salvaged burnt logs stored as inventory which had a year-end value of R96 million. Non-current liabilities have also increased over the years, largely due to the deferred tax liability resulting from the plantation valuation adjustments.

Cashflow statement

This statement is designed to show the cash generated in the three main areas of the business, namely operating activities, investment activities and finance activities. In the case of SAFCOL it can be seen that the main cash generating activity for the past four years has been operating activities.

R million	2003/04	2004/05	2005/06*	2006/07	2007/08
Cashflow from operating activities	(23.4)	91.7	17.9	140.3	213.9
Cashflow from investing activities	5.3	1.5	(24.4)	3.8	(106.6)
Cashflow from financing activities	(0.7)	(1.1)	0.8	14.2	(8.8)
(Decrease)/ Increase in cash and cash equivalents	(18.8)	92.1	(5.6)	158.3	98.6
Cash at the end of the period	88.7	180.8	175.1	333.6	433.0

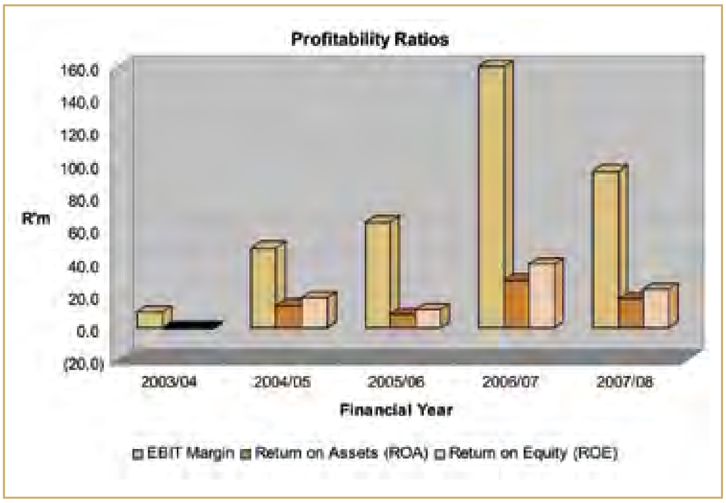
***Figures for 2006 are for nine months due to a change in financial year-end from 30 June to 31 March**

The above table reflects that SAFCOL is in a positive cashflow position. This means that SAFCOL has a good ability to generate cash especially from operating activities. Operating activities are generally expected to continue in the following year. This cashflow therefore shows that SAFCOL can be expected to be a good generator of cash in the following financial year. This argument is strengthened by the fact that the cashflow position of SAFCOL has improved over the period under review. Please note that the perceived decline in performance in 2005/06 was due to the fact that the financial year reflected a nine-month period. The consistent increase in cashflow is attributable to the profitability of the operations and decreasing working capital requirements.

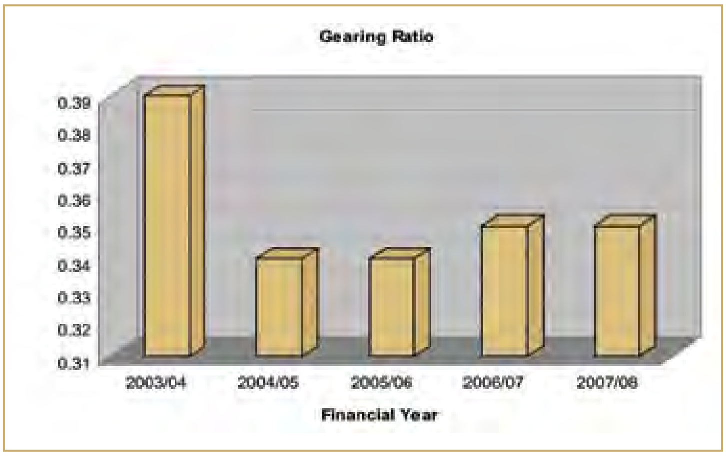
Key ratios

	2003/04	2004/05	2005/06	2006/07	2007/08
EBIT margin %	9.5	48.7	64.6	159.8	95.7
Return on assets %	(0.6)	13.5	8.3	28.9	17.6
Return on equity %	(0.8)	18.2	11.1	39.1	23.7
Gearing ratio (Times)	0.39	0.34	0.34	0.35	0.35

The table above reflects a sustainable and profitable picture



for the company. This can be seen through the high EBIT margin. The peaking performance in the 2007 financial year (operating profit margin, ROE and ROA), is mainly due to the fair value adjustment of R861 million realised in that financial year. The high ROA and ROE ratios reflect that SAFCOL is profitable and that it is yielding a high return on investments.



The gearing ratio is flat throughout the five years as a result of the minimal use of debt.

Capital expenditure

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Capital expenditure	32.9	28.2	11.3	44.5	76.5

The above table shows that the capex programme has been limited over the first four years of the review period. This is mainly due to the privatisation process, where the focus was on maintaining operations as opposed to expanding the business. The main focus of the capex programme was on sawmilling equipment, harvesting and transport equipment and vehicles. After 2006 the Group embarked on a programme to improve the average age of its fleet of transport equipment and vehicles. The 2008 year-on-year capital expenditure increase of 72% is due to the fact that purchased assets recognised in this financial year were ordered in prior years. The budgeted capex for 2008 was R113.5 million; the variance between the actual (R76.5 million) and budget was due to the long lead time in delivering equipment and due to the group's efforts to procure from BEE suppliers. Another focus area is investment in the renewal of sawmilling equipment to improve production efficiencies.

OPERATIONAL PERFORMANCE

Forestry management

In terms of sustainable forestry management, SAFCOL is effectively managing the forests under its control. With the exception of the Mozambique forests where there is no Forestry Sector Charter (FSC) authority, all SAFCOL forest are FSC compliant. In addition, SAFCOL has been issued with a FSC certificate for another five-year period.

SAFCOL's efficient management is also evident in the fact that the value of their forests has increased steadily over the years. Of concern however is the impact that fires have had on their forests in the past financial year. SAFCOL therefore has to continue to ensure that they have fire mitigating procedures in place.

SOCIO-ECONOMIC PERFORMANCE

Skills development

SAFCOL has achieved the following in terms of its skills development initiatives:

94 bursars were supported in the 2007/08 financial year (2006/07: 65 bursars), this includes employees and non-employees; and

210 ABET trainees in 2007/08 (2006/07: 203 trainees).

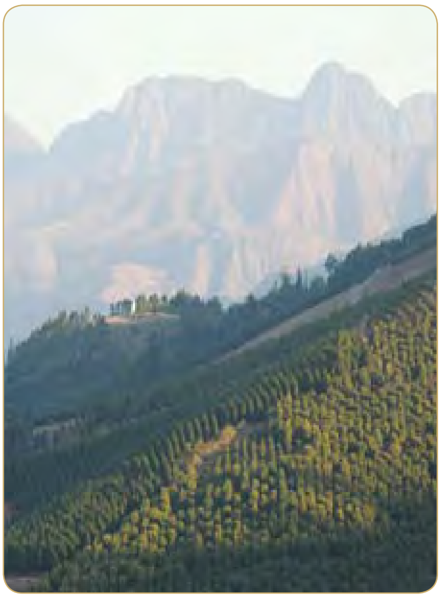
SAFCOL's aim is to put as many employees as possible through skills development programmes. In 2007 the company implemented a formal performance management scheme. SAFCOL maintains an in-house training facility at Platorand; the training facility offers training courses to promote an integral approach towards training which is aligned with the priorities of the business. The above mentioned skills developments will in future years be measured against the Forestry Sector Charter which came into effect in May 2008. The objective of the Charter is to transform the forestry industry to enable BBBEE participation in the forestry sector.

SAFCOL continues to endeavour to create employment equity in the workplace as well as increase its procurement spend on black business. SAFCOL has established a service provider database where suppliers are requested to supply the procurement section with details of their BEE rating in terms of the Department of Trade and Industry (dti) Balance Scorecards for BBBEE.

Research and Development

The focus of SAFCOL's R&D has been on softwood sawlogs and more specifically on enhancing the volume and quality of its standing timber stock. The company invested 1.17% of revenue in the 2007/08 (2006/07: 1.06%) in research aimed at improving the genetic material of its forests. To this end, it maintains permanent sample plots for monitoring growing trends and growth modelling. The KLF research facility is also unique in South Africa in its production and conservation of genetic material for the softwood sawlog industry through its network of seed orchards and gene banks.

In the next twelve months the enterprise development programme will focus on a medicinal tree nursery with special emphasis on indigenous plants.



4.5 DENEL

DENEL IN PERSPECTIVE

Denel, the State-owned arms and original equipment manufacturer has suffered from sub-optimal performance for many years due to a decrease in local defence spending.

A turnaround strategy was developed in 2005. The strategy has progressed significantly and losses have shown a declining trend in the past five years, with this trend expected to continue. The balance sheet does not currently support additional financing required. Turnover during the period under review was mixed and declined overall from R4.4 billion in 2003 to R3.8 billion in 2007/08. However, revenue has steadily increased since 2005/06. The company showed a loss of R347 million in 2007/08, a significant improvement from the previous loss of R1.4 billion in 2005/06. Further end-state restructuring of Denel is underway to ensure the consolidation and long-term viability of the SOE.

Denel was created in 1992 from manufacturing and industrial subsidiaries of Armscor including most production and research facilities and over 15 000 employees. Since its formation Denel has operated in a challenging environment. Due to changing government priorities, defence spend has reduced by 54% in real terms since 1990. In addition, 71% of equipment spend was on imports from 2000 to 2005. Denel has had to rely heavily on exports to survive. However, high growth developed markets are not directly accessible to independent contractors such as Denel. For example, only 2% of the NATO landward market of $34 billion is accessible to non-NATO countries. These trends have meant that Denel has needed to position itself differently, both in terms of local and export markets.

The turnaround strategy is centred around focusing the business on manufacturing sub-systems and components, the disposal of non-core assets, corporatisation, the formation of equity partnerships with global original equipment manufacturers (OEM) and the raising of productivity and standards to world class levels. Equity partnerships will ensure greater access to developed markets, whilst ensuring that world class skills and technology are transferred to Denel. Consolidation within the local industry remains a key imperative. Businesses have been ring-fenced to isolate risks, non-core assets to the value of R1 billion have been disposed of. Equity partnerships have been entered into with Carl Zeiss Optronics in Denel's Optronics business and Saab in the Aerostructures business, whilst the Rheinmetall Waffe Munitions merger with Denel Munitions is at an advanced stage.

Progress has been made with regards to access to local defence spend for the industry with the awarding of significant contracts over the past two years. In December 2007, Cabinet set a target of 60% to 70% of defence spend that will be directed towards the local industry in areas that have capacity and competitive advantage. Further acquisition policy reforms may be necessary and it will be important that the principle of multi-year orders is implemented to ensure sustainability for Denel and the broader industry.

Whilst sustainable solutions have been put into place for the Denel businesses mentioned above, further restructuring is underway as the final phase for ensuring that Denel becomes viable on a long-term basis. It is likely that Denel will consolidate further. Over the coming year, equity partnerships will also need to be bedded down and there will need to be greater emphasis on achieving efficiencies and cost reductions across the group. The organisation will also need to continue to focus on risk management, both from a financial and operational point of view.

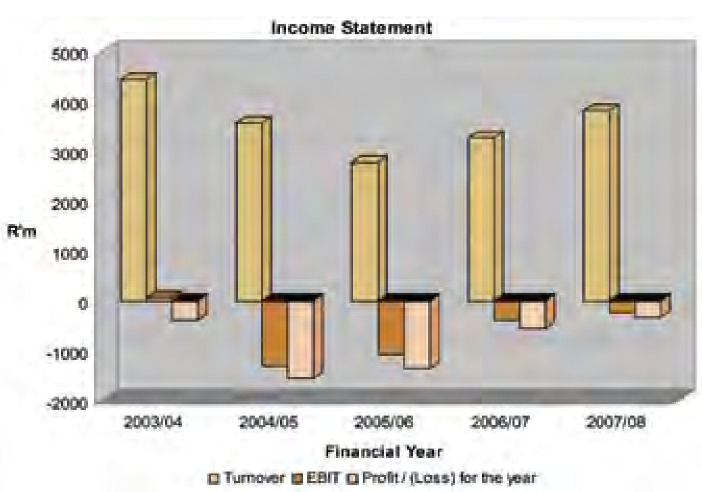
FINANCIAL PERFORMANCE

As can be seen from the table below, the group's net loss has reduced significantly over the last four years, with a 78% decrease from 2004/05 net loss of R1 561 million to a net loss of R347 million in 2007/08. This reflects an improvement in the overall financial management of the company as well as progress in the unbundling of the organisation to establish stand-alone business units. Each restructured entity will have its own board, leadership team and business strategy.

Income statement

The income statement summarises Denel's income and expenditure over the financial year. The following table highlights the main income and expense items. Operating income reflects the income that Denel can reasonably be expected to generate in the next financial year. It therefore excludes discontinued operations and non-operational income/expenses such as tax, investment income, interest expense and profit from associates. Net operating income reflects the type of income that would be expected to be generated in the next financial year but not necessarily the value of the income. The value of the income will be influenced by factors such as increasing prices, interest rates, exchange rates and demand.

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Revenue	4 442.2	3 572.1	2 773.1	3 268.1	3 818.1
EBIT	62.2	(1 314.7)	(1 076.3)	(386.8)	(232.7)
Profit/(Loss) from continuing operations	(384.4)	(1 415.7)	(1 310.7)	(507.3)	(321.3)
Profit/(Loss) for the year	(377.5)	(1 560.7)	(1 363.4)	(549.1)	(347.2)



As can be seen from the previous graph, Revenue has declined over the first three years under review. This is largely due to a decrease in demand and therefore a decrease in local sales. This has meant that Denel has had to rely on export sales in unreliable markets. This sales trend has however reversed over the past two years with local demand picking up, which resulted in Denel experiencing an increase in revenue of 38%. The improved net profit performance over the last four years has been mainly due to declining operating costs and increasing revenue.

Balance Sheet

While the income statement indicates the results of operations over a certain period of time, the balance sheet provides a financial view of the company at a specific point in time. In this instance the final view is on 31 March 2008. Equity and liabilities reflect the source of capital whereas the asset side of the balance sheet reflects how the capital is used. Current Assets and Current Liabilities are items that are not expected to appear on the balance sheet at the end of the next financial year 2009. For example a Current Asset is inventory which will be sold in the next 12 months and a Current Liability is an account which is payable within the next 12 months.

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Non-current assets	1 350	2 173	1 601	1 348	1 476
Current assets	2 742	2 410	2 724	2 616	3 607
Equity	835	(16)	615	633	1 328
Non-current liabilities	90	1 732	2 096	856	721
Current liabilities	2 347	2 888	1 938	3 000	3 081

As can be seen from the above table, Denel's financial position has improved over the last three years after deteriorating significantly in 2004/05, when the equity was negative. The substantial net loss of R1 561 million posted in that year was largely attributable to high operating costs and low gross profit margins. The low gross profit margins were implemented to cover the costs. The solvency of the business has improved over the last three years due to the fact that Government has supported Denel by contributing R3.5 billion to equity. A large percentage of the R3.5 billion was used to settle legacy debt. Denel originally requested a recapitalisation amount of R5.2 billion.

Cashflow statement

This statement is designed to show the cash generated in the three main areas of the business namely operating activities, investment activities and finance activities. In the case of Denel it can be seen that the main cash generating activity over the past four years has been from financing activities largely due to the Government recapitalisation.

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Cashflow from operating activities	(55)	(261)	(1 147)	(1 015)	72
Cashflow from investing activities	(146)	(145)	86	70	150
Cashflow from financing activities	53	417	1 483	555	400
(Decrease)/ Increase in cash and cash equivalents	(148)	11	422	(390)	621
Cash at the end of the period	295	306	730	338	964

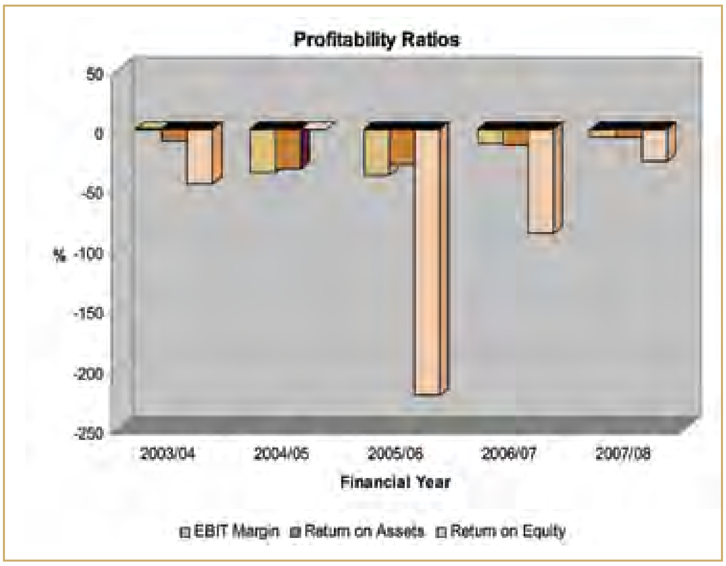
The above table shows that Denel's cash position has been fluctuating over the five years, with net cash outflows in 2006/07 and 2003/04. The cash position at the end of 2007/08 is as a result of the improved operational activities, the sale of non-core businesses and the cash injection from Government. Denel's high working capital requirements, its loss making position and the need to invest in capital expenditure have impacted the business' cashflow position.

Key ratios

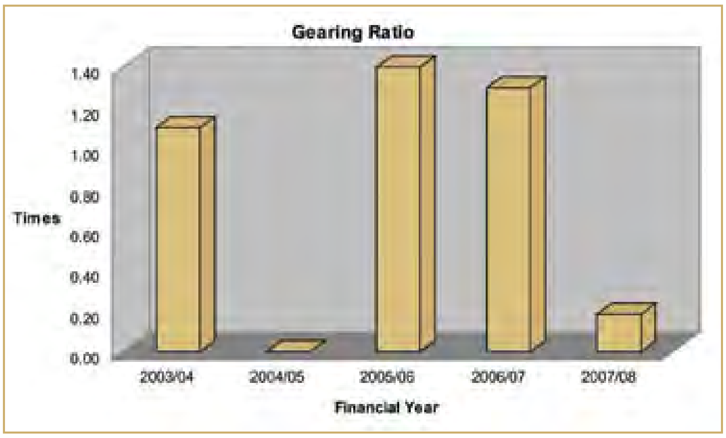
	2003/04	2004/05	2005/06	2006/07	2007/08
EBIT Margin %	1.4	(36.8)	(38.8)	(11.8)	(6.1)
Return on assets %	(10.1)	(33.4)	(29.9)	(12.2)	(6.8)
Return on equity %	(45.6)	-	(221.7)	(86.8)	(26.2)
Gearing ratio (Times)	1.10	-	1.40	1.30	0.18

*** In 2004/05 Denel had a negative equity.**

As can be seen from the table above, there has been a marked improvement in the profitability of the business. This is shown by the increasing EBIT margin percentage. Return on Assets and Return on Equity are a further indication of the positive change in the profitability of the business.



The Profitability ratios show an improvement in the last three years.



Note: The gearing ratio is based on interest bearing debt over equity.

The gearing ratio has improved significantly in 2007/08 mainly due to Government's support. The gearing ratio reduced in 2007/08 due to the repayment of the R825m corporate bond.

Capital expenditure

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Capital expenditure	142	83	122	100	270

There has been a significant increase in capex, from an average of 3% of sales from 2003/04 to 2006/07 to 8% in 2007/08. It is critical that Denel invests in capex in order to increase efficiencies and competitiveness. The 2007/08 financial year result is under the set target of 12.8%. Due to Denel's loss making position, capital expenditure is limited to investing in plant and equipment. The major portion of the capital expenditure was allocated to Denel's aerostructures business.

OPERATIONAL PERFORMANCE

Operating costs as % of Turnover

	2003/04	2004/05	2005/06	2006/07	2007/08
Operating costs %	26	46	42	38	28

Operating costs have decreased over the period under review; this has been one of the drivers for the improved financial performance. However, Denel's operating costs are still higher than the industry norm of 19% of revenue. In order for Denel to reach the 19% norm, it needs to invest in new plant and equipment to improve operational efficiencies.

SOCIO-ECONOMIC PERFORMANCE

Skills Development

Denel spent R11.6 million on internal training in 2007/08, of which R7.3 million was spent on previously disadvantaged employees (including white females). Denel is supporting 209 bursars; this includes external (68) and internal bursars (141). The majority of bursaries were for courses in engineering and related disciplines. The majority of the bursaries are awarded to previously disadvantaged individuals.

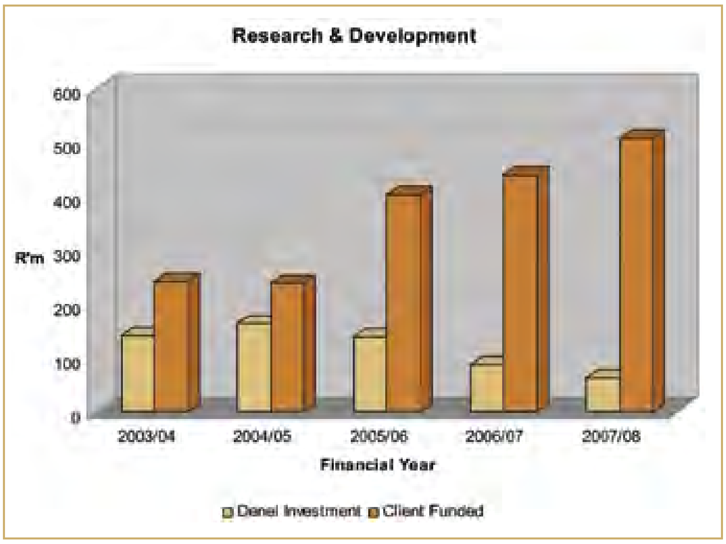
In addition to bursaries and internal training programmes, the company conducts external training through the Denel Centre for Learning and Development (DCLD), which forms part of its commitment to the JIPSA. Training at the DCLD includes non-aerospace trades and the centre is currently training 97 apprentices for Eskom (out of a total of 289). The company also operates the Denel Youth Foundation Training Programme (DYFTP) and a Schools Outreach Programme aimed at ensuring increased participation and improved performance in mathematics, science and accounting subjects amongst young people and school leavers. The DYFTP is aimed at learners from previously disadvantaged communities in rural areas.

Preferential Procurement

There is a dedicated department in the Denel Corporate office responsible for preferential procurement policies, transactions and other implementation mechanisms for the group. Of Denel's total procurement spend during 2007/08, 10% was spent on BEE companies compared to an average spend of 21% from 2004/05 to 2006/07.

Since there are relatively few BEE companies operating in high technology, defence-related aerospace and landward military business, Denel has pursued a strategy of facilitating the entry of BEE firms into its supply chain. Where it proved difficult to find fully BEE compliant suppliers in core business areas, Denel actively sought to give preference to BEE suppliers of non-production materials and services.

Research and Development



Over the reporting period, Denel invested modestly in technology development, whilst funding from the Department of Defence has shown a steady increase. However, R&D investments in general remain sub-optimal for ensuring the retention of assigned technology domains and sustained product competitiveness. The alliances that have been formed with equity partners should increase R&D investment levels significantly to be in line with the international benchmark of 8 to 10% of sales spent on R&D. Denel has spent an average of 3.4% of sales on R&D over the five-year period.

TRANSNET

delivering on our commitment to you

4.6 TRANSNET

TRANSNET IN PERSPECTIVE

Transnet is the State-owned freight logistics group, formed in 1990 with the corporatisation and restructuring of the old

South African Railways and Harbours and South African Transport Services (SATS). Over the period under review, Transnet has been transforming into a focused freight transport company delivering integrated, efficient, reliable and cost-effective port, rail and pipeline services.

Transnet's key role, as defined by the shareholder, is to assist in lowering the cost of doing business in South Africa and to enable economic growth through providing appropriate ports, rail and pipeline infrastructure and operations in a cost effective and efficient manner and within acceptable benchmark standards.

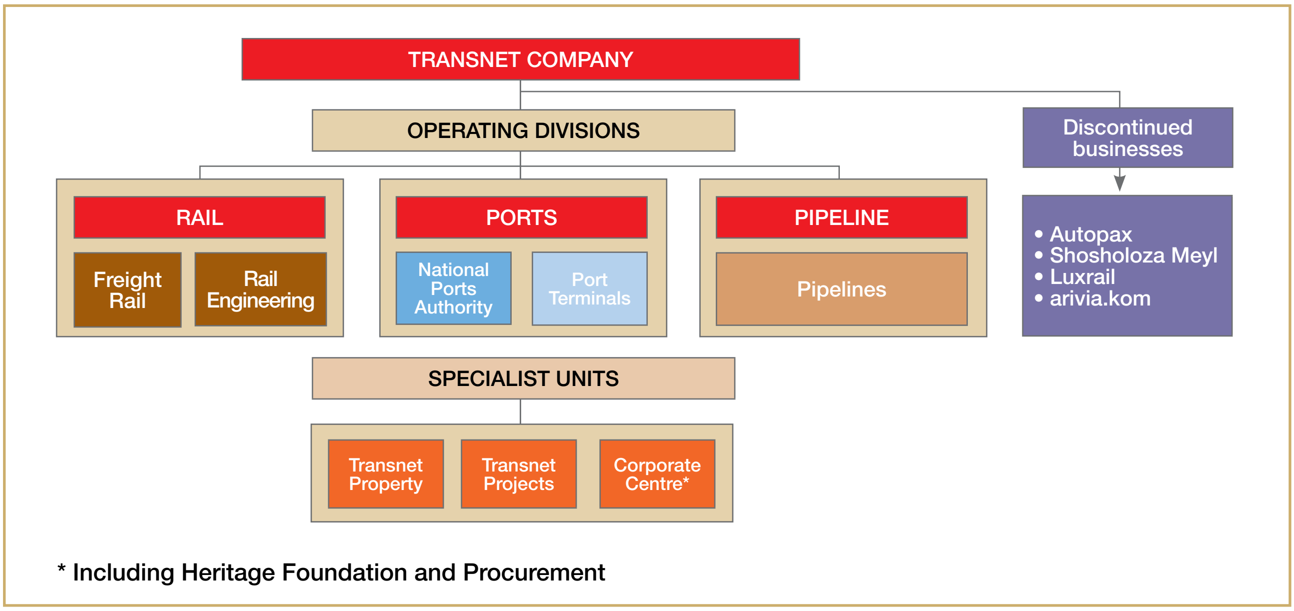
Transnet is primarily made up of the following core divisions:

- Transnet Freight Rail (formerly Spoornet);
- Transnet Rail Engineering (formerly Transwerk);
- Transnet National Ports Authority (formerly the NPA);
- Transnet Port Terminals (formerly SAPO); and
- Transnet Pipelines (formerly Petronet).

In 2003, Transnet was in a precarious financial and operational position. Between 2003 and 2008 Transnet embarked on a four-point turnaround strategy to improve the fortunes of the company. The four-point turnaround strategy consisted of:

- Strategic Balance Sheet management (including disposal of non-core assets);
- Corporate Governance and Risk Management;
- Business Re-engineering; and
- Human Capital

While the financial turnaround of Transnet has been exceptional, operational turnaround has been rather muted even though Transnet's re-engineering programme has yielded some positive results. Together with the capital investment programme, it is hoped that continued operational improvement through Vulindlela will position Transnet to be able to offer capacity ahead of demand. Prior to this, there had been an under investment in rolling stock and maintenance for twenty years. Challenges experienced with the maintenance side of the business impacted negatively on the reliability and productivity of rolling stock. This has been partially reversed as additional investment to sustain and expand infrastructure is ongoing.



Transnet Freight Rail (TFR) is the major contributor of revenue, contributing 44.0% of Transnet revenues in 2007/08. Transnet National Ports Authority (TNPA) remains the major profit contributor, however, contributing 54.3% of the net profit before taxation.

Transnet is in the processes of expanding capacity at its ports, railways and pipelines. Transnet's capital expenditure programme was budgeted at R34 billion in 2004/05 and it has increased progressively each year to the point where it now stands at R78 billion in 2007/08. During the period under review, Transnet has spent R47.5 billion in capital expenditure. The capital expenditure for the next five years has been budgeted at R80.3 billion. Key projects that are underway include the expansion of the coal-line and the iron-ore export channel; upgrades to the rail line and port system; the widening and deepening of the port of Durban entrance channel; the redevelopment of Pier 1 as the container-handling facility; an increase in capacity of the car terminal; the widening, deepening and equiping of the Cape Town container terminal; the refurbishment and renewal of the freight rolling stock; the continued development of the port of Ngqura and the construction of a multipurpose pipeline.

The year ended 31 March 2008 was extremely challenging for the group. Nevertheless, it was a very successful year, as evidenced by improved financial performance, significant progress in the disposal of non-core businesses and investments and a stronger balance sheet. This comes on the back of sustained performance in these areas over the last three financial years.

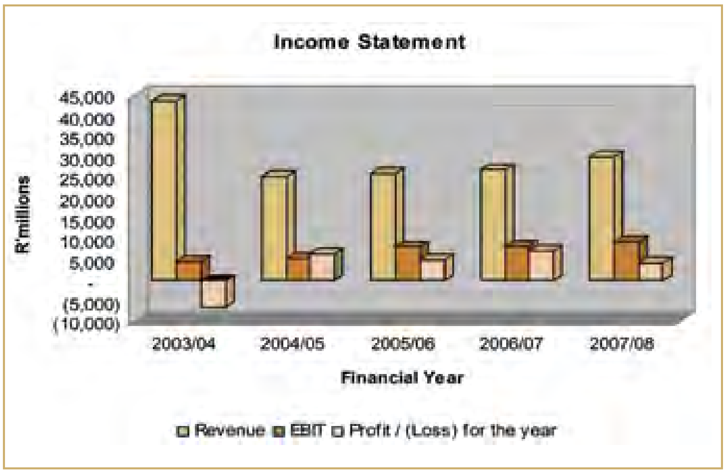
Highlights from the 2007/08 financial statements:

- Revenue increased by 11.9% to R30.1 billion (2006/07: R26.9 billion).
- Earnings before interest, taxation, depreciation and amortisation (EBITDA) increased by 18.3% to R13.2 billion (2006/07: R11.1 billion) enabling the EBITDA margin to increase to 43.8% (2006/07: 41.5%).
- Net finance costs decreased by 16.3% to R1.9 billion.
- Total assets of R98.9 billion, despite the disposal of several non-core businesses.
- Capital and reserves rose from R37 billion in 2007 to R51 billion in 2008.
- Transnet Freight Rail (TFR) recorded a 13.9% rise in revenue to R16.6 billion and a R1.6 billion (46.3%) increase in EBITDA. However, coal volumes decreased to 36.4 million tonne. Despite being a monopoly, the rail unit currently only enjoys 10% of the overland freight market, having shed market share at an alarming rate to the road hauliers over the last two decades.

FINANCIAL PERFORMANCE

Income statement

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Revenue	43 637	25 260	26 034	26 899	30 091
EBITDA	7 442	7 333	10 301	11 149	13 185
EBIT	4 750	5 414	8 138	8 200	9 387
Profit/(Loss) from continuing operations	(6 332)	5 810	4 828	6 215	6 232
Profit/(Loss) for the year	(6 332)	6 564	4 930	7 136	4 311



Transnet moved from a loss of R6.3 billion in 2003/04 to a profit of R4.3 billion in 2007/08. The compounded annual growth rate (CAGR) increase from 2004/05 to 2007/08 is a negative 13%. This is due to the impact of discontinued operations (2007/08: R1.9 billion). If the impact of discontinued operations was excluded, the CAGR increase in the profit from continued operations would have been 2%.

The CAGR increase in respect of EBITDA and EBIT from 2004/05 to 2007/08 is 15% and 19% respectively. This is due to the CAGR revenue increase of 6% far exceeding the operating expenses decrease of 5% over the four-year period ending 31 March 2008.

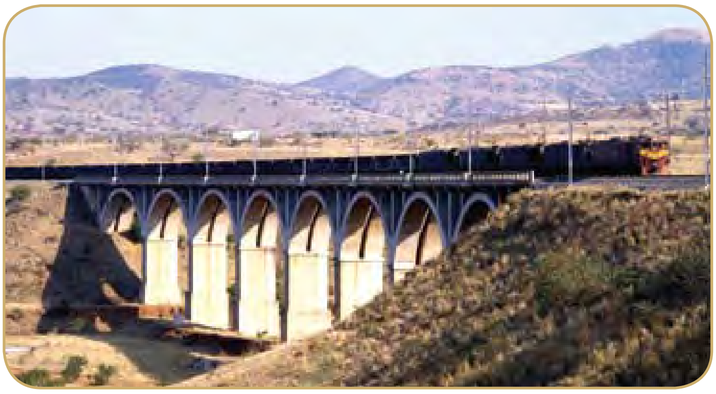
The above figures reflect the positive results of the turnaround strategy. The revenue increase of 6% is mainly due to tariff increases and, to an extent, volume increases. Transnet has managed to curtail its operating expenses through the initiation of efficiencies and cost cutting exercises. Furthermore there has been a systematic approach to dispose of the non-core businesses.

The following assets were classified as non-current assets held for sale and reported as discontinued operations during the period under review:

- SAA (Pty) Ltd
- South African Express (Pty) Ltd
- Transtel (FSN Assets)
- V&A Waterfront Holdings (Pty) Ltd
- Autopax Passenger Services (Pty) Ltd
- Freight Dynamics
- Viamax (Pty) Ltd
- Equity Aviation (Pty) Ltd
- VAE Perway
- Freight Dynamics Guard Risk
- Metrorail
- Transnet Housing Loan Book
- Shosholoza Meyl
- Transnet Pension Fund Administrators
- Luxrail (Blue Train)
- Transtel DEVI assets
- Arivia.kom
- Neotel (Pty) Ltd
- C class shares in Newshelf 697

The non-core assets are being sold as they are not deemed to be part of Transnet's core business. The proceeds of the sales are being used to part-fund the capital investment programme.

South African Express (Pty) Ltd, Shosholoza Meyl and Autopax Passenger Services (Pty) Ltd are in the process of being disposed. South African Airways (Pty) Ltd, Transtel FSN assets, Equity Aviation (Pty) Ltd, VAE Perways, Transnet Pension Fund Administrators, V&A Waterfront, Transtel's Devi assets, Transnet Housing Loan Book, Freight Dynamics, the C class shares in Newshelf 697 and Viamax (Pty) Ltd have already been disposed of. The total proceeds arising from the disposal of the assets were approximately R10 billion. The disposal of non-core assets has therefore had a significant impact on Transnet's turnaround over the five years under review.



Transnet capitalises maintenance expenditure (COPEX) since this expenditure enhances the value of the asset in terms of useful life and cashflows. This is in accordance with International Accounting Standards (IAS) which allows for capitalisation if significant parts are replaced in terms of IAS16. Had this expenditure not been capitalised, the profits would have decreased significantly from the reported results. The profit from continuing operations would have increased from a loss of R6.3 billion in 2003/04 to a profit of only R2 billion in 2007/08. The CAGR increase from 2004/05 to 2007/08 would have been a negative 29%. This shows that COPEX does have a significant bearing on overall profits.

Balance Sheet

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Non-current assets	57 156	59 967	50 144	58 277	84 077
Current assets	15 544	17 609	28 202	19 069	14 818
Equity	9 917	22 593	28 526	37 150	51 183
Non-current liabilities	32 217	29 755	22 189	23 184	27 862
Current liabilities	30 566	25 228	26 631	17 012	19 850

Non-current assets increased from R57.1 billion in 2003/04 to R84.1 billion in 2007/08. This is due to the accelerated capex spend of Transnet and the revaluation of property, plant and equipment. Equity increased from R9.9 billion in 2003/04 to R51.1 billion in 2007/08. This is mainly due to the increased profits generated over the period (see 4.6.2.2 above) from core operations, the disposals of non-core assets and the revaluation of property, plant and equipment.

The 2007/08 increase of R25.8 billion (44.3%) in non-current assets is largely driven by property, plant and equipment increases (R15.6 billion) and a revaluation of the port equipment amounting to R13.9 billion.

Cashflow statement

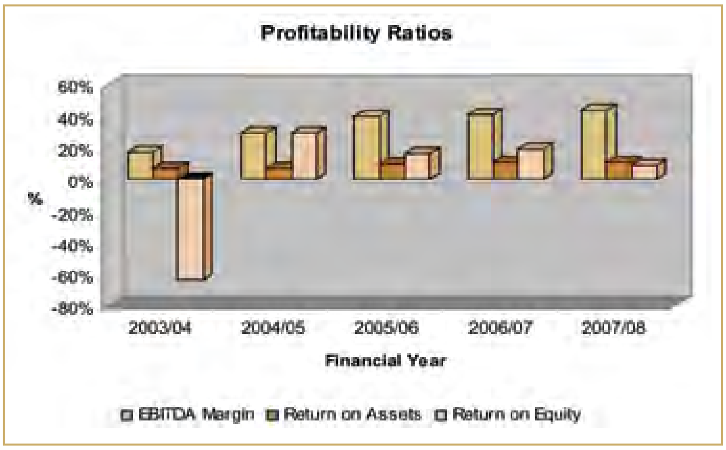
R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Cashflow from operating activities	3 113	546	5 865	8 903	10 858
Cashflow from investing activities	(5 468)	(5 001)	(2 479)	(10 307)	(8 234)
Cashflow from financing activities	5 696	2 437	(4 001)	3 669	9
(Decrease)/ Increase in cash and cash equivalents	3 341	(2 018)	(615)	2 265	2 633
Cash at the end of the period	4 324	2 306	1 691	3 956	6 589

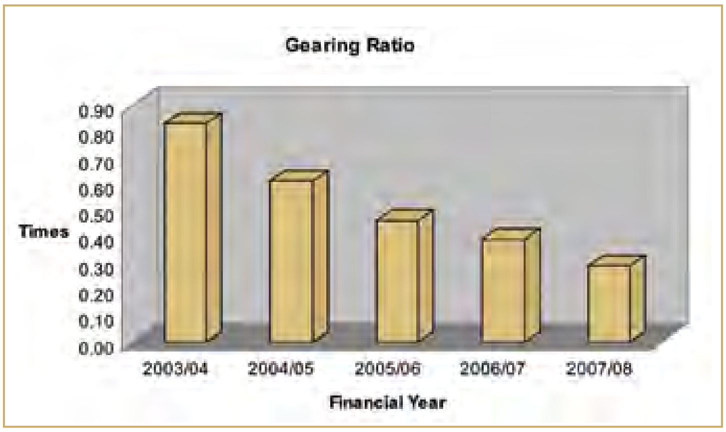
The cash balance at the end of the period has shown an improvement from R4.3 billion in 2003/04 to R6.6 billion in 2007/08 (CAGR = 11%) mainly due to improved cash generated from operating activities and the proceeds from disposal of non-operating assets, though offset by Transnet's accelerated capital spend.

The cashflow from operating activities has increased from R3.1 billion in 2003/04 to R10.9 billion in 2007/08, a CAGR increase of 37%. This is due to the improved profitability over the period under review (see 4.1.2.1 above). The low 2004/05 cashflow from operating activities amounting to R546m is due to an amount of R6.0 billion paid to unwind the SAA hedging positions. The cashflow from investing activities has increased from R5.4 billion in 2003/04 to R8.2 billion in 2007/08 due to the accelerated expenditure in property, plant and equipment. The cashflow from the financing activities decrease of R4.0 billion in 2004/05 is mainly due to the repayment of the T017 bond. The low cashflow from financing activities in 2007/08 of R9m is mainly due to the redemption of the T004 bond (R3.2 billion).

Key ratios

	2003/04	2004/05	2005/06	2006/07	2007/08
EBIT Margin %	17	29	40	41	44
Return on assets %	7	7	10	11	11
Return on equity %	(64)	29	17	19	8
Gearing ratio (Times)	0.83	0.61	0.46	0.39	0.29
Cash interest cover (Times)	3.5	4.8	4.5	5.5	7.0
CFROI	-	-	-	6.8	7.4





The Shareholder Compact financial indicators are EBITDA, cash interest cover, gearing ratio and CFROI. These targets have all been achieved in respect of the 2006/07 and 2007/08 financial years.

EBITDA margin increased from 17% in 2003/04 to 44% in 2007/08. This increase is largely attributable to tariff increases, productivity improvements as well as cost-saving initiatives undertaken by Transnet.

The return on assets percentage increased from 7% in 2003/04 to 11% in 2004/05. This increase is also driven by the factors mentioned in the paragraph above. This return is low in comparison to the Weighted Average Cost of Capital (WACC) percentage of 12.4% and this is due to the increasing asset base over the period under review. There is therefore a need to improve efficiencies even further in order to justify the increased asset base.

The liquidity ratios (gearing, interest cover and CFROI) all show a significant improvement over the period under review. Cash interest cover has improved from 3.5 times in 2003/04 to 7.0 times in 2007/08. The high interest cover demonstrates that Transnet is able to comfortably service its borrowings. The gearing ratio has shown the most significant improvement, increasing from negative 64% in 2003/04 to 29% in 2007/08. The improvement in cashflow has been discussed under 4.1.2.3 above. The liquidity ratios are evidence of Transnet's strong balance sheet which places the company in a favourable position to undertake its capital expenditure programme. It also however indicates that Transnet has the capacity to take on additional borrowings for capital expenditure purposes.

Capital Investment

Following the announcement by the President in his State of the Nation Address in May 2004 with respect to the five-year investment plans and financing strategies of SOE, substantive progress has been made.

The initial investment plan announced by Transnet in October 2004 amounted to R37 billion over the next five years, and has steadily increased to R80.3 billion in 2008 (excluding financing costs) to be spent on both replacing and expanding the ports, pipeline and rail freight core assets. Key corridor projects forming part of the R80.3 billion investment programme include:

- Sishen - Saldahna (R3.7 billion);
- Gauteng - Cape Town (R4.2 billion);
- Gauteng - Port Elizabeth, East London and Ngqura (R8.2 billion);
- Gauteng - Durban (R23.1 billion);
- Gauteng - Richards Bay (R9.4 billion);
- Gauteng - Maputo (R200 million); and
- Other nationwide investments (R31.5 billion)

Transnet's historical spend over the five-year period ending 31 March 2008 is reflected in the table below:

Transnet Capex Spend 2004 – 2008

Divisional Analysis	2003/04	2004/05	2005/06	2006/07	2007/08
Transnet Freight Rail	1 490	1 328	3 809	7 402	9 308
Transnet Rail Engineering	90	206	189	623	764
Transnet National Ports Authority	1 204	931	783	1 026	2 506
Transnet Port Terminals	385	658	776	1 764	2 082
Transnet Pipelines	82	136	220	315	887
Other	4 569	2 382	824	544	233
TOTAL	**7 820**	**5 641**	**6 601**	**11 674**	**15 780**

To have spent a cumulative R47.5 billion over the five-year period under review is a remarkable achievement and has never been accomplished in the history of the company nor by its predecessors. The major projects that Transnet undertook over this period included the fleet renewal and modernisation (R3.7 billion), upgrading of 200 additional class 18E locomotives (R1 billion), sustaining of the coal line (R1 billion), expansion of the ore line to 41 million tonne per annum (R1.3 billion), construction of the Port of Ngqura (R1.9 billion), Saldanha iron ore terminal (R1.4 billion), capitalisation of TFR projects (R6.7 billion) and other projects amounting to R11.7 billion. The capital investment programme is a critical component of ensuring that, at least insofar as port, rail and pipeline infrastructure is concerned, Transnet provides capacity at least in line with demand and hopefully ahead of demand. However, keeping up with such an aggressive capital investment programme places huge strain on the Transnet balance sheet and at some point becomes unsustainable without hiking tariffs significantly. DPE and Transnet will have to be vigilant about this possibility and explore ways of mitigating this risk.

One of the key challenges to timeous delivery of the capex programme is the impact of the global economic environment and notably the increased volatility in currency and equity markets. Nonetheless, in spite of the slower global economic growth both globally and locally, Transnet achieved R16 billion of capital investment activity for the 2007/08 financial year, a 35% increase from the previous year's figure. The planned R20 billion spending for the 2008/09 financial year will be further challenged by inflation, the depreciating rand, high interest rates and a generally lower economic growth.

OPERATIONAL PERFORMANCE

In general, TPT and Transnet Pipelines volumes have grown between 2003/04 and 2007/08. However, it is disappointing that volume growth has been rather static in TFR and TNPA during the period under review as it was probably the single largest and sustained economic boom cycle in the history of the South African economy.

Volume Growth %

Transnet Port Terminals (TPT)

As can be seen from the table, TPT has shown significant growth in most cargo categories during the past five years. However, the changing regulatory and policy environment (National Ports Act of 2005) is likely to curtail Transnet Port Terminals' (TPT) growth plans, commercial activities and future business models. Particularly in the container sector where TPT has a monopoly. The envisaged introduction of private sector operators is likely to impact on market share and volume growth.

The TPT volumes are reflected in the table below:

Ports – Terminal Operations	2003/04	2004/05	2005/06	2006/07	2007/08
Containers (millions TEUs)	2.5	2.9	3.0	3.4	3.7
Dry bulk (million tonne)	44	45	47	48	49
Break bulk (million tonne)	12	12	12	11	11
Automotive vehicles (thousand units)	261	332	556	474	542

Following phenomenal global growth in container shipping, total container volumes handled in the South African ports system increased from 2.5 million twenty foot equivalent unit (TEUs) in 2004 to 3.7 million TEUs in 2008, a significant 48% units increase over the five years.

Despite capacity restriction in both logistics chains and port terminals, dry bulk volumes have increased substantially over the years as capacity expansion projects were completed. Notably in 2006 TPT handled a record 28.8 million tonne through the Saldahna Ore terminal.

Volume growth in the break bulk sector has been offset by a general trend to containerisation coupled with increased private sector competition in this sector. Volume growth in the break-bulk sector has declined significantly and in real terms growth has been negative.

In the same period the automotive sector experienced a double increase in demand for handling services at the three car terminals – Durban, East London and Port Elizabeth, fuelled by the strong rand and low interest rates in 2006 which increased demand for vehicle imports. During 2007/08 Transnet Port Terminals commenced a process to create 4 000 additional slots at the Durban Car Terminal. On completion, the terminal's capacity will have grown from one berth (6 500 parking slots) in 2006 to three berths (14 000 parking slots).

While there has been some improvement in productivity at TPT operated terminals, particularly the container terminals, during the period under review, greater productivity increases, at least commensurate with revenue and profitability increases, could have been achieved. Operational productivity is an area that TPT will have to focus on very hard in the next five years in order to optimise the utilisation of port infrastructural capacity that it operates, as this will have tremendous flow-through benefits to the economy. TPT should strive to perform to best-in-class levels across all its operations as South Africa is further away from its major markets than its competitors are.

Transnet Freight Rail (TFR)

Considerable progress is reported in making TFR a scheduled railway service and the 2% increase in net tonne kilometres transported on the General Freight Business (GFB) is testimony to the turnaround (albeit slow) of the business unit.

The TFR volumes are reflected in the table below:

Transnet Freight Rail	2003/04	2004/05	2005/06	2006/07	2007/08
Volume - coal (million tonne)	66	67	68.7	67	63.5
Volume - iron ore (million tonne)	27	28	29.6	30	31.9
Volume - general freight (million tonne)	83	86	83.8	84.3	84.5
Total volume railed	176	181	182.1	181.3	179.9

Over the years volumes railed on the 20 000 km rail network have grown slightly. Total volume growth over the five-year period was 0.9%. In 2006 the total freight transported of 182 million tonne was marginally higher than the previous year's volumes.

As volume growth was achieved primarily on the export lines, a deliberate strategy was followed to move more productive rolling stock resources to the export lines. This strategy resulted in further deterioration of the GFB over the years. In 2007 only 79.6 million tonne of GFB was moved against a target of 85.0 million tonne. Similarly there was lower than expected volume growth in coal and iron ore customer segments due to the unavailability of product from suppliers.

Growth in the GFB segment remains a concern as TFR market share continues to deteriorate as more volumes are moved on road each year. The State of Logistics Surveys (SOL) shows that rail experienced a 2.5% decrease in volumes annually between 1997 and 2003. The surveys also show that rail managed to halt the declining volumes between 2003 and 2006. Transnet's volume growth figures for 2007 and 2008 show that the arrest of the decline has continued and that there has even been a very marginal increase in total freight volumes moved by rail. Unfortunately, what this means in relative terms is that rail's market share of the total land freight market has declined considerably over the five-year period under review. The first SOL Survey (completed in 2004) showed that the total land freight transport moved in the economy in 2003 stood at 1 173 million tonne. 973 million tonne of this total was moved by road and 200 million tonne was moved by rail (inclusive of the iron ore and coal export lines). The fourth SOL shows that in 2006 1 493 million tonne were moved by land. Of this, 1 291 was moved by road and 202 by rail. Analysis of growth in the land freight sector, based on GDP growth rates of 4.5% in 2006 and 4% in 2007 estimates that total land freight stood at 1 630 million tonne by the end of 2007/08 financial year. Rail volumes remained at 202 to 204 million tonne (though TFR data indicates that only 181.3 million tonne was railed) and road moved 1 426 million tonne. The data and analysis above shows that TFR's market share declined from 17% in 2003 to just 12.4% at the end of 2007/08 financial year.

The 2006 SOL Survey confirmed that all growth in land freight transport has been captured by road transport over the last ten years. Historical data for freight shipped in South Africa is, for the first time, reflected in the Fourth State of Logistics Survey in the graph below.

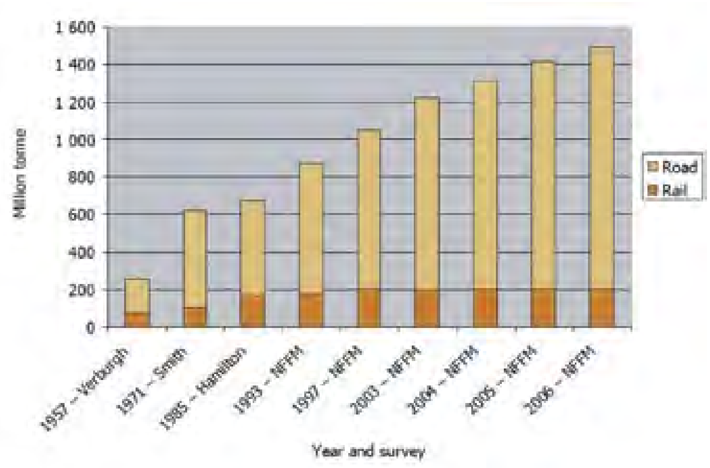


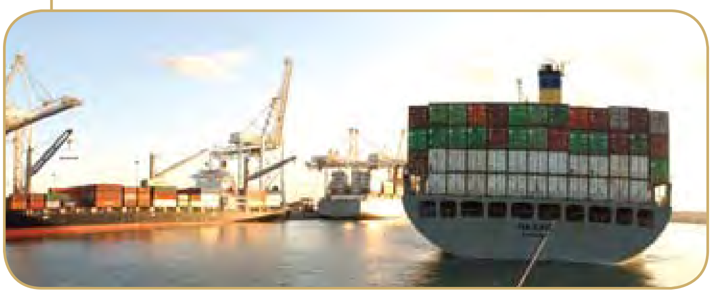
Figure 7: Historical freight transport data

Plans to separate the core and secondary network (branch lines) in line with National Freight Logistics Strategy (NFLS) will certainly assist in improving performance and efficiency on both networks and importantly, create opportunities and scope for the introduction of new rail operators.

Transnet Pipelines (TPL)

Volumes have remained fairly flat over the period under review as the pipeline system has virtually been operating at full capacity all the time. Despite this, marginal productivity improvements have resulted in improved revenues and profits for the division. Revenues had increased over the five years due to cost reduction and productivity measures even though the Regulator allowed very limited tariff increases.
One of the strategic challenges for the division in 2008 is completing the New Multi Product Pipelines (NMPP) project by the third quarter of 2010 whilst managing the transition to the NMPP in an environment of volatile product supply and irregular offtake of the product by clients. The global volatility in product supply necessitated the development of the Energy Security Master Plan (ESMP) by the Department of Minerals and Energy in 2006 to address security of fuels supply in South Africa. The ESMP requires the holding of strategic reserves by industry, and additional investments in product storage infrastructure.

In spite of a decrease in total volumes transported (a decrease of 4.8% from 2003/04 to 2004/05) the multi-product pipeline (DJP) out of Durban was operating close to 100% capacity throughout the year. The capacity plan study indicated a need for additional capacity between Durban and Gauteng in early 2008. In 2006 Transnet lodged a successful licence application with NERSA to construct the new pipeline and successfully completed the feasibility study for the NMPP. Presently Transnet Pipelines transports approximately 17 billion litres of petroleum products and 14 million gigajoules of gas annually. The refined product volumes conveyed through the Transnet pipeline network is greater than 50% of the South African consumption.



Productivity Improvement - Personnel Cost

	2003/04	2004/05	2005/06	2006/07	2007/08
Freight Rail					
Number of employees	34 771	32 516	31 398	24 811	24 577
Revenue per employee	0.39	0.44	0.45	0.59	0.68
Rail Engineering					
Number of employees	*	6 538	6 418	14 951	13 486
Revenue per employee	*	0.46	0.60	0.49	0.60
NPA					
Number of employees	3 544	3 419	3 236	3 251	3 173
Revenue per employee	1.28	1.46	1.68	1.88	2.16
Port Terminals					
Number of employees	5 464	5 196	4 853	5 049	5 395
Revenue per employee	0.54	0.63	0.74	0.81	0.90
Pipelines					
Number of employees	568	542	448	483	446
Revenue per employee	1.62	1.88	2.37	2.52	2.77

The above table shows that in general the revenue per employee indicator is improving from 2003/04 to 2007/08. This is due to the progressive revenue increase over the years coupled with the decrease in the divisional headcounts. The number of employees decreased from 48 211 in 2004/05 to 47 077 in 2007/08. Transnet lost 1 134 employees between 2004/05 and 2007/08.

SOCIO-ECONOMIC PERFORMANCE

Competitive supplier development programme

SOE deliver their infrastructure investment programmes through procuring goods and services from local and global suppliers. Global suppliers are used for products and services which are only available overseas, or when there are problems with the capacity, capability and competitiveness of the local supply base. Due to relatively low expenditures over the past thirty years, the capacity of South African supply industries has been significantly reduced and it is forecast that there will be at least a 40% import requirement for the infrastructure investment programmes in Transnet.

The Transnet R80.3 billion capex programme is an opportunity to leverage Transnet expenditures to optimise the development of competitive national supplier industries and where possible, to build export capabilities. Against this backdrop, in 2007 the DPE together with Transnet and Eskom put in place a competitive supplier development programme (CSDP), which involves procuring in such a way as to increase the competitiveness, capacity and capability of the local supplier base, where there are comparative advantages and potential competitive advantages of local supply.

The CSDP replaces the National Industrial Participation Programme (NIPP) which is an import-offset programme (for government expenditure) managed by the DTI. The NIPP required that suppliers of imports costing more than $10 million work with the DTI to invest the equivalent of 30% of the value of the purchase in a non-related industry. Since the inception of the NIPP ten years ago, the DTI managed the obligations of seven Transnet suppliers amounting to R1.2 billion.

The CSDP aims to achieve its goals without diverting Transnet from the timely delivery of the capex programme. The overall long-term national target that the DPE has set for the programme is to increase the participation of the national industry from 60% to 70% of the Transnet capex and operating expenditures by 2012. In February 2008 Transnet submitted its supplier development plan compiled in terms of the CSDP. In this regard, a Transnet procurement capacity, capability and professionalisation programme has been put in place.

Economic impact

Over the past five years, the South African economy grew at a strong pace averaging 5%. Transnet is contributing to the economic growth through major infrastructure investment of R47.5 billion and thereby addressing one of the constraints identified in ASGISA namely the cost, efficiency and capacity of the national logistics systems. Transnet's investment of R80.3 billion over the next five years is focused on key corridors and sectors. Investment in fixed capital will remain a key support to economic growth over the next five years, driven by extensive public sector infrastructure development and its effect on private investment and capacity expansion.

Transnet contributes to the employment growth indirectly through the multiplier effects (the indirect and induced effects) on economic growth. Developing human capital and strengthening the skills base are core objectives of Transnet's new strategy.

4.7 SOUTH AFRICAN AIRWAYS

SAA IN PERSPECTIVE

South African Airways (SAA) is a main line full service network airline that operates domestic, regional and intercontinental scheduled services for the carriage of passengers, freight and mail. It is the largest carrier in Africa and was a wholly owned subsidiary of Transnet until 31 March 2006, when it became a standalone SOE reporting directly to the DPE.

The period leading up to SAA becoming a standalone enterprise was characterised by a number of challenges. These included the deep uncertainty affecting the global airline industry after the 9-11 attacks, the ongoing liberalisation of markets and price sensitivity amongst passengers driving a move to low-cost, no-frills carriers and volatile energy prices. Airlines across the globe have responded to the challenges with attempts to improve efficiency and labour productivity and through the building of global alliances. In addition, SAA faced significant foreign exchange losses in 2003/04.

SAA has responded to these challenges by seeking to leverage its membership of the global Star Alliance, launching its own low cost carrier, Mango, and embarking on a restructuring programme that includes a far-reaching cost-cutting programme.

Details of the restructuring include:

- A labour concessions programme that will save R683 million on personnel costs;
- Up to 30% of managers being retrenched;
- The grounding of six Boeing 747 aircraft, with their pilots being retrained on other aircraft;
- Discontinuation of some loss-making routes; and
- Cost reduction and revenue enhancements.

In March 2007, the Government provided a R1.3 billion guarantee to restore balance sheet solvency. A guarantee of R1.56 billion was made available in November 2007 to cover costs related to the grounding of the B747-400 fleet and a transfer of R744 million was made during 2007/08 to cover costs of the labour concessions associated with the restructuring.

The restructuring programme has been effective in reducing costs but less effective in targeted revenue management and certain operational challenges remain, in particular high fuel prices. This reduced the potential for the achievement of better financial performance in the 2007/08 financial year.

SAA focused on cost cutting and revenue growth and achieved R1 billion of cost savings in 2007/08. SAA was fortunate to be able to restructure in a buoyant market. The low cost carrier, Mango, has performed in terms of market share and revenue but is yet to be profitable.

EBIT for 2007/08 did not reach the targeted R695 million. Despite this, and considering the high fuel prices, SAA has managed to turn the company around, with a profit before restructuring costs of R123 million in 2007/08. Fuel costs were in excess of R900 million above budget as the airline industry did not anticipate the oil price reaching US$110 per barrel.

In the medium term, SAA seeks to reduce its on- and off-balance sheet debt. At present SAA's on-balance sheet gearing is 167% and the current debt/equity structure is expensive. Going forward, as a result of the global slowdown and high fuel prices, SAA will continue to face a challenging competitive environment. There is also a need to debate SAA's role as a State-owned network carrier in relation to competition from other foreign based airlines flying to South Africa.

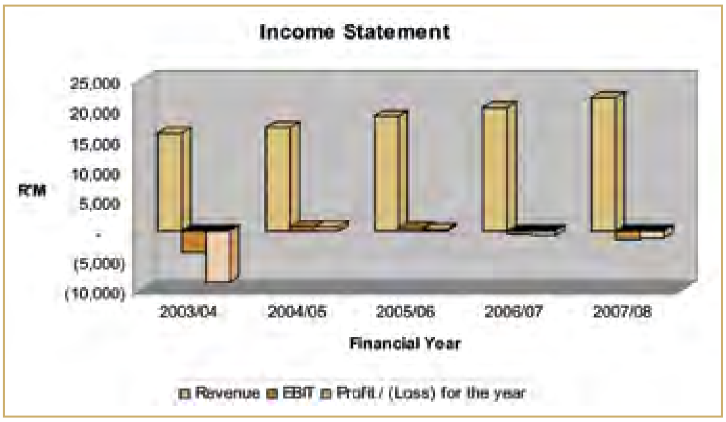
SAA's strategic vision is to be an African airline with global reach. SAA provides air services connectivity to and from South Africa and is increasing its level of operations locally and into Africa while ensuring that intercontinental routes are maintained. SAA provides South Africa with increased connectivity in the development of international and intra-continental trade and tourism. In this regard SAA offers cost effective and world class quality service in competitive markets.

FINANCIAL PERFORMANCE

Income statement

The following table and graph summarise SAA's financial performance for the period under review.

	2003/04	2004/05	2005/06	2006/07	2007/08
Revenue	16 339	17 186	19 128	20 524	22 257
EBITDAR	2 449	3 006	2 857	2 590	2 597
EBIT	(3 643)	581	395	(650)	(1 372)
Profit / (Loss) for the year from continuing operations	(8 620)	739	112	(932))	(1 088)
Profit / (Loss) for the year	(8 620)	648	65	(883)	(1 085)



The five-year period began with SAA experiencing significant losses resulting from fair value adjustments of R4.4 billion in 2003/04 that negatively impacted its profitability. While revenue has steadily increased, poor revenue/yield management, cost control and increased fuel costs have eroded the benefits of passenger growth and necessitated the restructuring of the business in the 2007/08 financial year.

Balance Sheet

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Non-current Assets	9 433	10 582	8 749	8 352	7 204
Current Assets	7 454	6 646	5 240	6 824	10 366
Equity	(2 697)	2 705	1 179	1 570	2 496
Non-current Liabilities	4 789	5 953	4 593	5 034	4 191
Current Liabilities	14 795	8 570	8 217	8 572	10 883

*** Note: Between 2004 and 2007 financial years restated figures have been used wherever applicable.**

The non-current assets have steadily declined as a result of SAA's inability in acquiring ownership of new aircraft and recognizing such equipment on its balance sheet and, instead, resorting to off balance sheet finance for fleet requirement funding.

The Government provided SAA with a guarantee of R1.3 billion in March 2007 and R1.56 billion in November 2007 respectively to restore its balance sheet solvency and to cover the restructuring costs associated with the grounding of its B747-400 fleet in November 2007.

Cashflow statement

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Cashflow from operating activities	(1 403)	(4 087)	327	237	1 375
Cashflow from investing activities	(4 422)	(298)	1 456	(162)	(7)
Cashflow from financing activities	8 144	4 029	(3 043)	731	1 557
(Decrease) / Increase in cash and cash equivalents	2 319	(356)	(1 260)	806	2 925
Cash at the end of the period	2 977	2 614	1 440	2 363	5 390

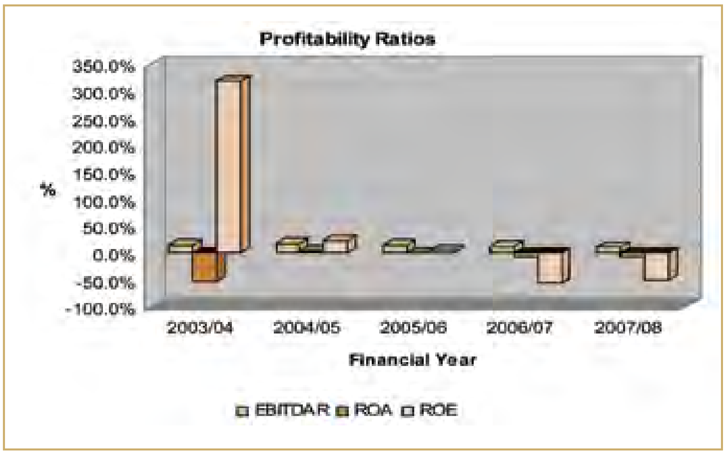
*** Note: Between 2004 and 2007 financial years restated figures have been used wherever applicable.**

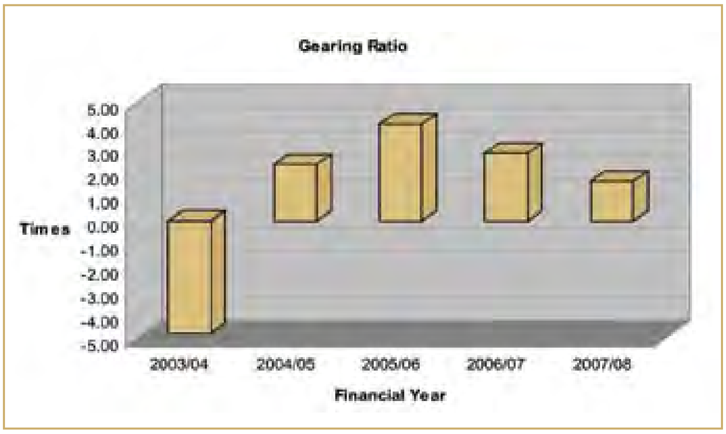
SAA's cash position has improved with cash at year-end in 2007/08 of R5.39 billion. The main contributor to this increase is the cash received by SAA from subordinated loans raised through Government guarantees.

Key ratios

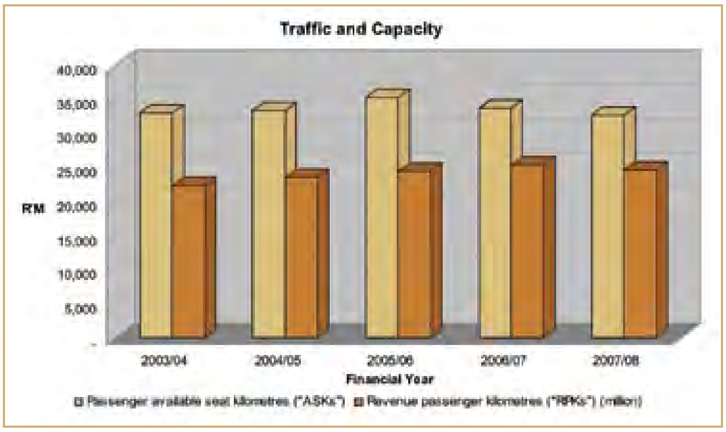
	2003/04	2004/05	2005/06	2006/07	2007/08
EBITDAR Margin %	14.99	17.49	14.94	12.6	11.68
Return on Assets %	(51.05)	3.76	0.46	(5.8)	(6.18)
Return on Equity %	319.61	23.96	5.51	(56.2)	(43.47)
Gearing Ratio (times)	(4.74)	2.41	4.13	2.89	1.67
EBITDAR/ (Lease rentals + Interest)	1.2	1.7	1.3	0.9	0.8

The chart below depicts SAA's performance in terms of EBITDAR, ROA and ROE.





SAA has a low Return on Equity (ROE) and Return on Assets (ROA) figure of a negative 49.0% and 7.0%, respectively. This indicates the insufficient return from the use of assets and the historical inability of SAA to generate overall profits.



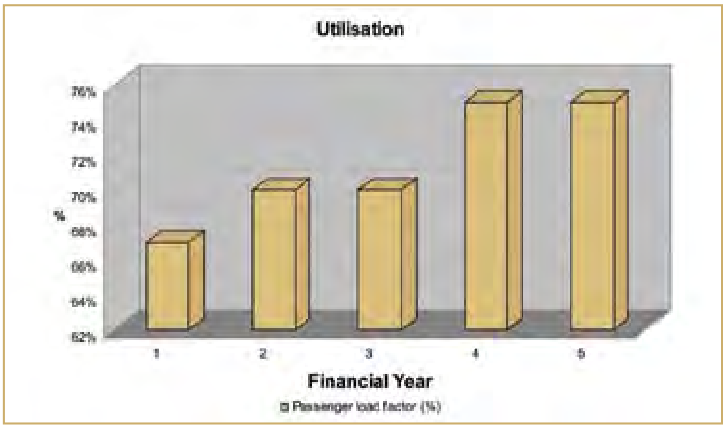
Capacity produced in the network as measured in ASKs reduced in the last two years due to the closure of certain unprofitable intercontinental routes and downscaling of size of long haul equipment operated. This also stemmed the growth of traffic measured in RPKs over long haul operations in the last year.

CAPITAL EXPENDITURE

Expenditure indicators

R MILLION	2003/04	2004/05	2005/06	2006/07	2007/08
Capital expenditure	3 947	1 964	335	269	179
Maintenance spent	1 167	1 106	1 466	1 524	2 066

Most recently capital expenditure at SAA was curtailed due to the restructuring process that is currently being undertaken.

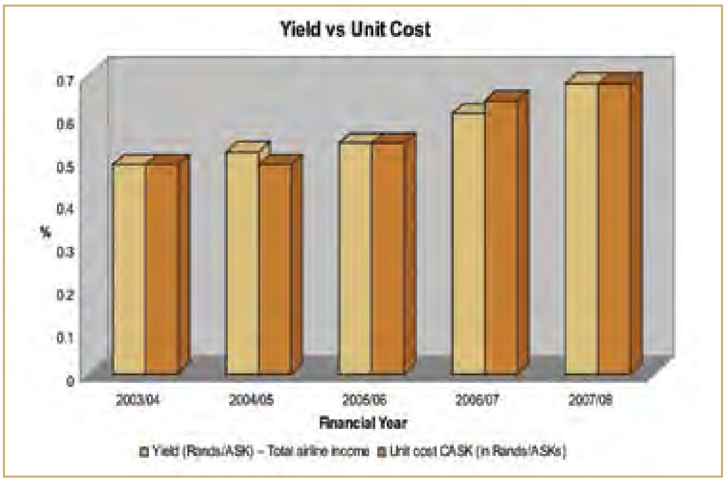


Average load factors have increased over the network due to better management of supply and demand thereby preventing the costs of excess capacity.

OPERATIONAL PERFORMANCE

Operating data indicators

Capacity (million)	2003/04	2004/05	2005/06	2006/07	2007/08
Passenger available seat kilometres (ASKs)	33 056	33 367	35 222	33 671	32 680
Traffic					
Revenue passenger kilometres (RPKs) (million)	22 306	23 505	24 488	25 381	24 619
Revenue passengers (thousands)	6 510	6 851	7158	7 727	7 444
Passenger revenue (R million)	12 926	13 163	12 747	14 230	16 527
Utilisation					
Passenger load factor (%)	67	70	70	75	75
Yield (Rand/ASK) – Total airline income	0.49	0.52	0.54	0.61	0.68
Unit cost CASK (in Rand/ASKs)	0.49	0.49	0.54	0.64	0.68



Average yield per unit now recovers unit cost of production.

SOCIO-ECONOMIC PERFORMANCE

Supplier development

SAA manages procurement through a bid adjudication council which approved supplier contracts to the value of R471 million for 2006/07, of which R234 million went to BEE suppliers, representing a 700% increase over 2005/06.

BBBEE procurement

In the 2007/08 financial year a procurement diagnostic system that enables the airline to integrate the procurement procedure with the SAP system was implemented to enable SAA to report on all the requirements for BBBEE reporting and procurement. The system will ensure that all acquisition of goods and services in excess of R500 000 have followed proper procurement process and that the process has complied with PFMA, Preferential Procurement Policy Framework Act 5 of 2000 (PPPFA) and BBBEE requirements. SAA's bid processes are being reviewed to ensure that they are properly geared to support BBBEE initiatives whilst taking into consideration SAA's current financial condition.

The "procure to pay" systems are currently being upgraded to ensure improved governance and reporting capabilities to report on the current level of BBBEE procurement status of ongoing contracts. The system is expected to be operational shortly.

Skills development and training

SAA aims to increase the number of previously disadvantaged individuals in the aviation sector and is focussing on the following fields: Technical, Engineering, Information Technology, Airport Operations and Flight Operations. Six cadets (two Indian woman and four Indian men) have already successfully completed the assessment process, having potential to become airline pilots. They have since commenced their training at the 43rd Air School.

Economic impact

SAA's contribution to the economy is as a facilitator of economic growth, tourism, trade, industry and international relations by providing connectivity and transhipment of air travellers and goods through its network of routes. Furthermore, SAA has a direct impact on total revenues and procurement as well as employment in the air transport industry and other industries both on the demand and supply side of the airline industry.

In particular SAA facilitates growth in the tourism sector by flying the largest number of foreign visitors to South Africa of all airlines providing competitive air services to and from South Africa. This sector is particularly important in developing job creation as part of the tourism ASGISA objectives.

The geographical location of South Africa necessitates competitive air services connectivity for the normal functioning of the economy and trade and industry. SAA has developed OR Tambo International Airport as an intermediate hub providing connectivity on long haul flights between the East and the West apart from the traditionally important North to South air traffic flows. SAA has also developed an extensive route network across the African continent, connecting its base with traffic flow to its domestic and international flights. SAA serves most of the key African destinations.

SAA offers a safe and reliable quality air service in a cost effective and efficient manner. In consolidating its operation and focusing on core competencies, SAA seeks to offer an economical and sustainable route network.

Research and Development

No research and development programmes have been implemented due to the restructuring process.

4.8 ALEXKOR

ALEXKOR IN PERSPECTIVE

Alexkor was established in 1989, when the State Alluvial Diggings was transformed into the Alexander Bay Development Corporation. Since November 1992, Alexkor has been run as a public company with the State as sole shareholder. Up until 2007/08, the company consisted of two major divisions, namely Alexander Bay Mining (ABM) and Alexander Bay Trading (ABT). The ABM division is the core business unit, actively exploiting a large land-based diamond resource and extensive diamondiferous marine deposits. These activities are complemented by geology, exploration, ore reserve planning, rehabilitation and environmental management. The non-core ABT businesses are centred on agriculture and maricultural production. Apart from providing employment opportunities in the region, Alexkor maintains and provides basic municipal services including housing, refuse removal and the supply of electricity and potable water in Alexander Bay. Water services are also provided to communities in Port Nolloth and Beauvallon. Alexkor also provides retail facilities, education facilities, churches, law and order, emergency services and various sporting facilities. Until recently, the company provided hospital services to Alexander Bay and beyond, with patients coming from surrounding towns like Kuboes, Oranjemund and Port Nolloth. The management of the hospital was transferred to the Northern Cape Department of Health at the beginning of April 2007.

Alexkor's distinctive competencies are its quality of diamonds and its unique land and mineral resources. Over the life of the mine, approximately 10 million carats of gemstone quality diamonds have been recovered. However, for the last ten years Alexkor has been subject to a number of business constraints:

- Lack of a diamond reserve. Land mining operations are currently exploiting an inferred resource and the marine operations are exploiting a diamond deposit
- The loss making land mining activities are limited to the north of the mine where plant capacity exists, but where the diamond resource is the most depleted
- Deteriorating sea conditions over the last ten years has limited the ability of the marine diver operations to produce
- Costs have not declined relative to revenue over the past few years, except for 2007/08
- Ongoing subsidisation of non-core activities (ABT, town maintenance etc.)
- The land claim dispute with the Richtersveld Community which prevented access to capital required for exploration and replacement of equipment and infrastructure.

These constraints resulted in ever decreasing diamond recoveries over the years.

On 22 April 2007, the Deed of Settlement in the Richtersveld Community's land claim for a parcel of land situated in Alexander Bay was signed. This has considerably changed the landscape of Alexkor and the Namaqualand region. In terms of the Deed of Settlement ending the dispute, Alexkor's land mining rights will be transferred to the community, while marine rights are retained by Alexkor. The agreement provides for the formation of a Pooling and Sharing Joint Venture (PSJV) between Alexkor and the Richtersveld Community, with 51% of shares in the PSJV vesting in Alexkor and the remainder with the Richtersveld Community. The PSJV will put in place a mine development plan and programme to upgrade the land and sea diamond resources and will develop a business plan to constitute a viable mining venture. A Joint Board has been formed to oversee the preliminary establishment phase of the PSJV. This will involve the appointment of an executive committee which will develop a business plan for the continued operations of the mine. Alexkor's agricultural and maricultural assets were transferred to the Richtersveld Community's agricultural holding company in January 2008. Agricultural land is to be transferred during 2008/09. Alexander Bay will be formally established as a township and the Richtersveld Local Municipality will then take over the

provision of engineering services and other public services and fulfil all functions which a local authority has to perform.

In the interim, in order to give effect to the agreement and to address the company's financial losses, Alexkor identified the following strategic objectives:

- Exiting non-core business activities;
- Temporary closure of own land mining operations;
- Maintenance of marine and land mining production through contractor operations;
- Submission and approval of amendments to the mine's environmental management plan; and
- Conversion of old order mining rights to new order rights and the transfer of the land rights to the Richtersveld Mining Company.

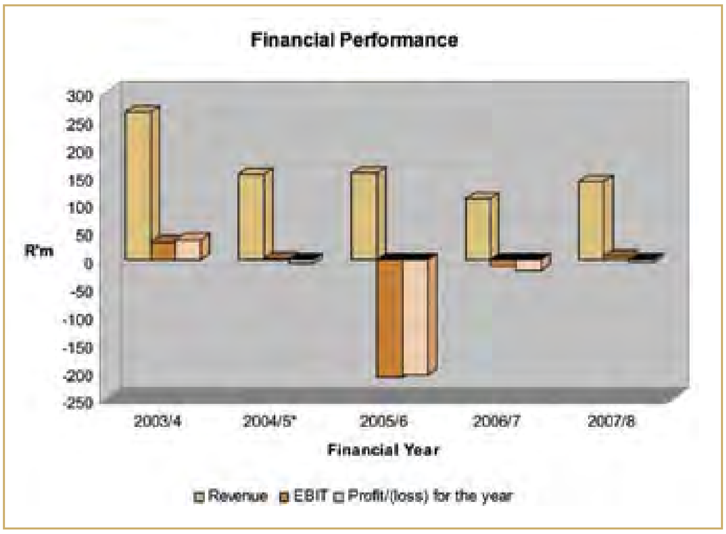
At present the mining operations are in need of investment in new equipment as the limited equipment currently in operation requires maintenance. In addition, there is a need to conduct an extensive exploration programme in order to upgrade the current inferred diamond resource to an indicated diamond resource. From the indicated resource, mining feasibility studies will potentially allow the delineation of a diamond reserve from which a reliable business plan can be developed for the exploitation of that reserve.

FINANCIAL PERFORMANCE

Income statement

The following table and graph summarise Alexkor's financial performance for the period under review:

R 'M	2003/4	2004/5*	2005/6	2006/7	2007/8
Revenue	264.7	152.4	154.8	109.3	139.8
EBIT	31.8	1.5	(209.7)	(9.8)	5.9
Profit/(loss) from continuing operations	37.8	(6.0)	(205.5)	(1.6)	9.6
Profit/(loss) for the year	35.7	(6.0)	(205.5)	(19.1)	(4.8)

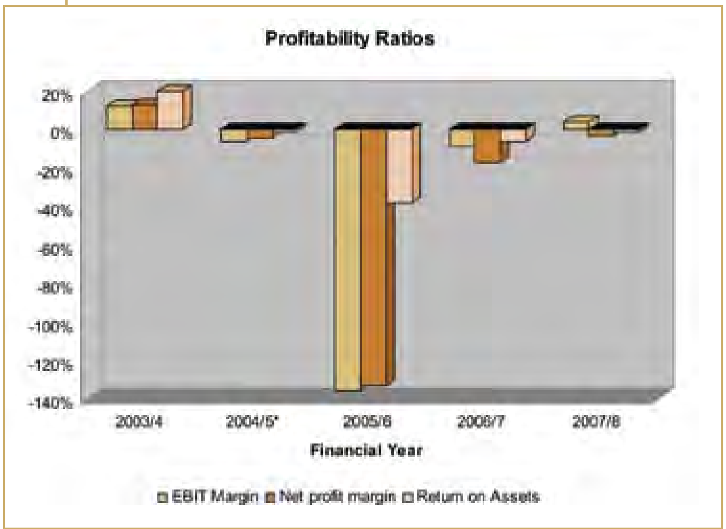


*** Note: Figures for 2004/05 are for nine months due to a change in financial year-end from 30 June to 31 March**

Alexkor's revenue declined from R264.7 million in 2003/04 to R109.3 million in 2006/07. Strong diamond prices and a favourable exchange rate pushed revenue up to R139.8 million in 2007/08, despite a drop in carat production. Substantial provisions for environmental rehabilitation amounting to R159.9 million in 2005/06 and R19.9 million in 2006/07 impacted the company's operating profit significantly. Subsequently, Alexkor's operating costs showed a declining trend from R170.8 million in 2006/07 to R156.6 million in 2007/08, primarily as a result of the decrease in land mining activities. The gross loss of R16.7 million in 2007/08 was offset by specific expense reimbursement amounting to R21.7 million and Government funding of R44.7 million (206/07: R32.9 million) in order to sustain the company's operations and ensure the company was able to settle its obligations over the short term. Alexkor recorded an operating profit of R5.9 million in 2007/08 following two years of operating losses. The operating profit of R5.9 million in 2007/08 was however offset by a loss from discontinued operations (the agricultural and maricultural business units and hospital). The combined loss from discontinued operations coupled with a tax expense adjustment resulted in a net loss after tax of R4.8 million in 2007/08 (2006/07: R19.1 million).

The following table and graph depict Alexkor's performance in terms of EBIT margin, net profit margin and return on assets for the period under review:

Year	2003/4	2004/5*	2005/6	2006/7	2007/8
EBIT Margin %	12.00	(5.99)	(135.00)	(8.98)	4.23
Net profit margin %	13.50	(3.91)	(132.81)	(17.47)	(3.41)
Return on Assets %	19.95	(1.04)	(37.95)	(5.67)	(1.14)



Alexkor's profitability ratios improved in 2007/08, with a positive EBIT margin recorded for the first time since 2003/04.

Balance Sheet

R million	2003/04	2004/05	2005/06	2006/07	2007/08
Non-current Assets	64.1	470.8	476.3	225.1	222.0
Current Assets	115.0	103.2	65.2	111.7	196.0
Equity	40.3	430.2	221.8	(33.0)	(37.7)
Non-current Liabilities	110.7	118.9	301.5	287.1	312.0
Current Liabilities	28.1	24.9	18.3	82.6	143.7

Alexkor's financial position deteriorated significantly in the last three years. The impact of adjustments made for post-retirement medical liability and rehabilitation liability in 2005/06 and resultant loss eroded the company's capital and reserves. Furthermore, Alexkor was compelled to impair its property, plant and equipment as well as non-current assets as a result of the Deed of Settlement. As a result of net loss of R4.8 million, accumulated loss increased to R258.6 million, further eroding Alexkor's capital and reserves to a net negative R37.8 million equity position in 2007/08.

Cashflow statement

The following table and graph sets out the cashflow results for Alexkor for the period under review:

R MILLION	2003/4	2004/5	2005/6	2006/7	2007/08
Cashflow from operating activities	31.72	(0.62)	(7.03)	(33.1)	(24.6)
Cashflow from investing activities	(24.71)	(16.70)	(9.48)	(1.25)	64.25
Cashflow from financing activities	(2.96)	(2.50)	-	80.44	64.45
(Decrease) / Increase in cash and cash equivalents	(4.04)	(19.82)	(16.51)	46.13	104.12
Cash and cash equivalents at end of period	71.42	51.55	10.12	96.36	200.48

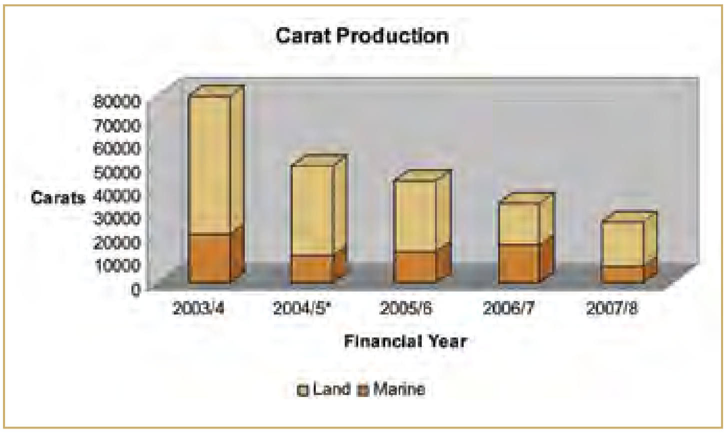
Alexkor received R63.3 million as compensation for some of its assets utilised for restitution to the Richtersveld Community in 2007/08, bolstering the company's cash position. Although total cash and cash equivalents amounted to R200.5 million as at 31 March 2008 (2007: R96.3 million), only R124.5 million remained available for operational purposes. The balance of cash and cash equivalents is earmarked for ongoing litigation (R8.2 million), government-funded projects (R44.9 million for township establishment, implementation of the Deed of Settlement and rehabilitation at Boegoeberg) and rehabilitation trust funds (R22.8 million).

OPERATIONAL PERFORMANCE

Carat production

The following table and graph depicts Alexkor's carat production for the period under review:

	2003/4	2004/5*	2005/6	2006/7	2007/8
Land	20 441	11 123	13 161	15 900	6 411
Marine	59 284	38 454	30 046	17 603	19 209
Total	79 725	49 577	43 207	33 503	25 620



Alexkor's diamond production declined significantly over the period under review, from 79 725 carats in 2003/04 to 25 620 carats in 2007/08. The bulk of the carat production has been from marine operations. However, this has reduced as a result of deteriorating sea conditions and consequent reduction in safe diving days over the period as illustrated below:

Diamond recoveries from land mining operations also declined over the period. Despite attempting a three-shift configuration in 2006/07 which resulted in 21% higher production from land operations compared with the previous period, equipment failures and the high operating cost associated with the use of an aged earth-moving fleet and infrastructure necessitated downscaling of operations in 2007/08.

Operating costs as % of Revenue

	2003/04	2004/05	2005/06	2006/07	2007/08
Operating costs %	88	106	235	109	96

A decrease in operating costs was recorded from 235% of revenue in 2005/06 to 96% in 2007/08. Operating costs decreased proportionately with the decrease in land mining activities.

SOCIO-ECONOMIC PERFORMANCE

Skills Development

Alexkor participates in JIPSA and has focused on training and development of artisan-assistants into qualified artisans. Of the six bursaries allocated in the company's bursary programme, five were granted to historically disadvantaged candidates from the Richtersveld and the broader Namaqualand region. Alexkor introduced training programmes to up-skill employees and make them computer literate. ABET programmes up to level 4 were introduced to employees and members of the Alexander Bay community. A succession planning policy, which incorporates skills assessment and career pathing, has been developed and implemented. The succession planning policy makes provision for mentoring of employees who have been selected to undergo extensive training. Employment opportunities such as engineering learnerships, diamond evaluation, trainee geologists, junior metallurgists and trainee engineers have been filled by historically disadvantaged individuals.

With the settlement of the land claims case, a restructuring of the Alexkor workforce has been undertaken with the separation of the ABT workforce from Alexkor, and the reduction in the ABM workforce numbers. Whilst the ABT labour reduction was effected through a voluntary separation agreement and a transfer of the remaining employees under section 197 of the Labour Relations Act No. 66 of 1995, as amended, the ABM workforce was reduced through a voluntary severance agreement and a forced retrenchment under section 189 of the Labour Relations Act. Of the 76 ABT employees engaged before the restructuring only three employees were transferred. The balance accepted the voluntary separation offer. The vast majority of the employees who accepted the voluntary separation package have since been re-employed by the Richtersveld Agricultural Holding Company (RAHC) to whom the assets of ABT have been transferred. The ABM workforce was reduced by 87 employees, 49 of whom accepted a voluntary severance offer, whilst 38 were retrenched under section 197 of the Labour Relations Act as surplus to requirements in terms of the 2009 business plan. All aspects of the restructuring were discussed with and agreed to by organised labour and management. The current workforce of Alexkor comprises 111 people who are engaged in mining activities in support of the contractor-based mining operations, and in maintenance of the Alexander Bay Town infrastructure.

Intrinsically linked to the restructuring process was a post-restructuring support initiative for affected employees which entails training interventions on portable skills so as to equip departing employees with skills that would heighten their prospects of re-employment, either within mining or in other work disciplines.

Supplier development

Alexkor set a target for procurement from historically disadvantaged South Africans to be over 25% for the period 2004 to 2007. In 2007/08, Alexkor procured goods and services from BEE companies which include mining contractors and companies providing services such as security, catering and maintenance. The spend on black-empowered companies amounted to R136 million, representing 61% of total spend. As part of its broader empowerment commitment, Alexkor supports the creation of micro-businesses through the awarding of shallow water and land mining concessions to various contractors. Part of the criteria to be granted a concession is that prospective contractors must have a fifty percent BEE component in its shareholding. A women empowerment consortium which was granted a land mining contract at Witvoorkop commenced operations during 2007. This initiative is aimed at developing the capacity of women to independently manage a mining operation and alleviate poverty amongst marginalised women. Further initiatives to ensure female participation in the local economy include female equity ownership in shallow water and land mining concessions which accounts for approximately 18% of the shareholding in these contracts.

NON-CORE OPERATIONS

The Company discontinued the non-core ABT operations on 21 January 2008 and transferred the related movable assets to the RAHC in accordance with the Deed of Settlement. The hospital was transferred to the Northern Cape Department of Health at the beginning of the year and the airport will be transferred to the relevant state entity in the future. For 2007/08, the discontinued operations incurred losses of R14.4 million compared to the loss of R17.5 million during the previous year. The establishment of Alexander Bay as a municipal town has advanced well with the completed general plan of the town awaiting final authorisation in order to ensure the integration of the town with the regional needs. The Development Bank of Southern Africa has been introduced to the programme to act as an implementing agent for the establishment of the township. To date R3.9 million has been spent on the planning of the town establishment and the associated upgrading of services to municipal standards.

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