



Denel Annual Report Presentation Portfolio Committee on Public Enterprises

1 November 2006



**Global supplier
of world-class products**

Agenda



- Situation Analysis
- Strategy Imperatives
- Annual Report and Recapitalisation
- Strategy Implementation Process & Status
- Transformation
- Non-Core Disposal

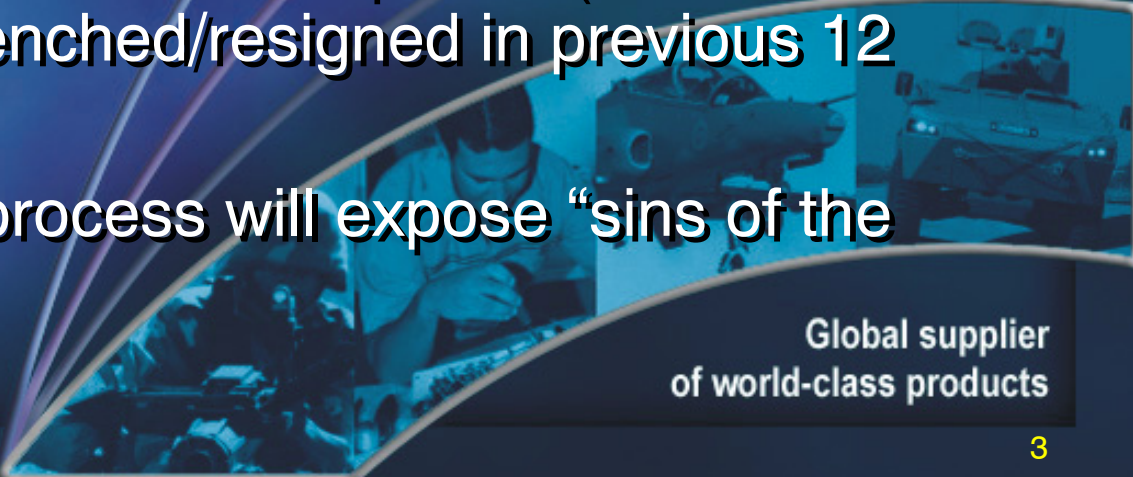


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Situation Analysis (1)



- Momentum in the right direction is under way
- Signs and belief of recovery are reflected in many areas of the company
- Broader stakeholder community are engaged and interacting
- Number of deals/tenders increasing, impacting positively on gross pipeline
- Most retrenchment activities completed (more than 1000 personnel retrenched/resigned in previous 12 months)
- The re-engineering process will expose “sins of the past.”

A blue-tinted background image showing a person working at a workstation in a factory or workshop setting. The person is wearing a white shirt and is focused on their work. The background is slightly blurred, emphasizing the person in the foreground.

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Situation Analysis (2)



- Introduction of a tighter financial management ethic, new management and financial skills (CEO's and CFO's), PWC (internal audit) and KPMG (IFRS)
- Numerous risks still prevail – projects, sales, skills shortages and skills losses
- Sustainable, annuity type revenue not yet apparent
- Equity discussions progressing
- Organizational effectiveness/transformation gaining momentum.

Nothing breeds enthusiasm and energy more than success

A collage of images showing industrial and automotive scenes, including a person working on a machine, a car, and a truck.

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Agenda



- Situation Analysis
- **Strategy Imperatives**
- Annual Report and Recapitalisation
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Strategy Imperatives (1) Pillars



Engage State Agencies

Secure Privileged Access

**Evaluate Commercial Viability
(Fix or Exit)**

**Create Equity Partnerships /
Alliances**

**Raise Capabilities and Productivity
to World Standards**

Transformation & People

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Strategy Imperatives (2)

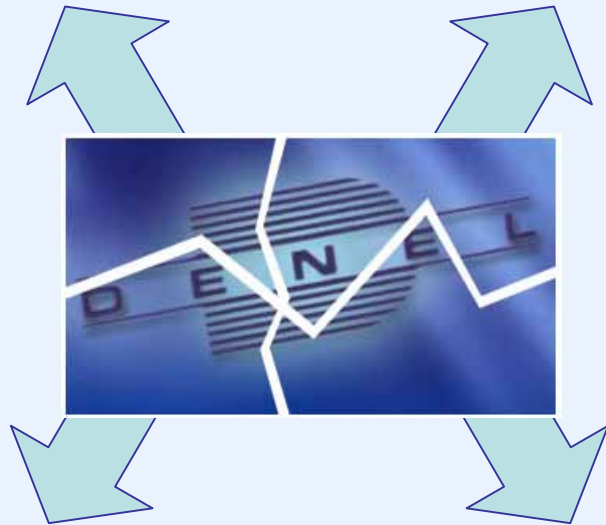
Single Vision Anything Else Will Not Help



From: Misalignment Amongst Stakeholders

President
and
Cabinet

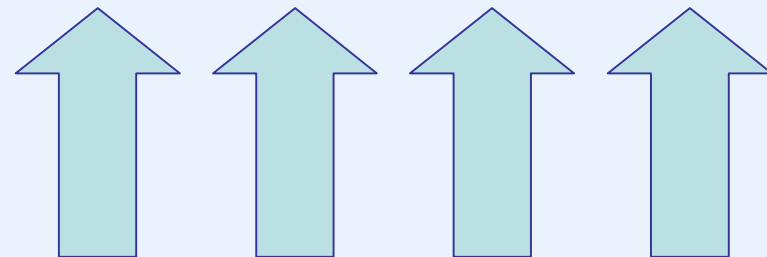
Portfolio Ministers –
DPE, DoD, Foreign
Affairs, Finance



Denel
Board

Denel
Executive
Team

To: Single Vision and Purpose



One Team

- President and Cabinet
- Portfolio Ministers
- Denel Board
- Denel Executive Team

or world-class products

Strategy Imperatives (3-1)

Guiding Principles



Transformation & People

- Transform Denel's people into a motivated, innovative and empowered workforce with a commercial and performance-based mindset within a truly representative and diverse environment

Engage State Agencies

- Initiate and participate in forums to ensure stakeholder alignment (DPE, DoD, Armscor, Industry) in areas of Industry Structure, Acquisition Policy, Industrial Participation
- Initiate, guide and participate in the formulation of a Defence Industrial Sector Strategy
- Appropriately communicate strategic principles and plans to ensure buy-in of all stakeholders

Secure Privileged Access

- Secure 70 % local spend of the defence acquisition budget as a policy decision (via a defence council)
- Visibility of the defence budget to enable long term planning for industry

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Strategy Imperatives (3-2)

Guiding Principles



Evaluate Commercial Viability (Fix or Exit)

- Evaluate business viability: capacity utilisation, sales, margins, overheads, markets, strategy
- Exit unviable businesses & product lines
- Restructure viable business: consolidate & right-size (focus on efficiencies, costs, overheads, productivity)
- Define acceptable hurdles: gross profit, EBIT (productivity, capacity utilisation)
- Business plan: “low risk” budgets & plans
- Creation of NewCos to ensure risk mitigation, governance and business focus

Create Equity Partnerships / Alliances

- Identify potential partners and engage to find synergies
- Conclude equity transactions
- Identify strategic alliances to increase market share

Raise Capabilities and Productivity to World Standards

- Identify, initiate and coordinate management interventions to ensure capability & productivity gains

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Agenda



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Board Committees



- Designed to best assist Board:
 - Audit and Risk Committee
 - Name changed: to include review of risk management systems
 - Audit sub-committees at subsidiary level
 - Advised Board on implementation of conversion to IFRS
 - 3 non-executive directors and one executive
 - Personnel and Remuneration Committee
 - 3 non-executive directors and one executive
 - To develop and monitor human resource strategies
 - Review broad remuneration strategies
 - Succession planning in key positions



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Chairman's Statement



- Denel went through unprecedented change
 - First time since 1992 faced insolvency, closure
 - Board approved macro strategy
 - Needed recapitalisation
 - Management achieved significant progress
- Highlights:
 - Identified need to improve internal audit (PricewaterhouseCoopers from 1 April)
 - Unbundling of divisional businesses
 - Matrix study into viability of businesses / products
 - Exiting some non-core businesses
 - Appoint business-oriented executives across all disciplines
- Clear vision exists to build sustainable enterprise. Denel still needs stakeholder support.

A collage of images in the bottom right corner, including a person working at a computer, a military vehicle, and a large aircraft.

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CEO Review



- Past year remarkable for progress made:
 - Mapped global defence environment
 - Positioned Denel / South Africa in context
 - Five pillar macro strategy (on foundation stone of *transformation and people*)
 - Buy-in for strategy from all stakeholders
- Government considers Denel strategic asset:
 - Strategic independence
 - Support of SANDF
- Total re-engineering of Denel:
 - Cost reductions, including staff reductions
 - Business processes improved
 - Business viability and product offering investigated
 - Potential for partnering / alliances
 - Roadmap with integrated stakeholder community



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Directors' Report



- Directors responsible for preparation, integrity and fair presentation of Group Annual Financial Statements of Denel (Pty) Ltd and its subsidiaries.
 - Statements presented in accordance with International Financial Reporting Standards, SA Companies Act and Public Finance Management Act
 - Appropriate to use going concern basis for financial statements
 - External auditors responsible for independent auditing and reporting



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Directors' Report (contd.)



- The Group:
 - Established 1 April 1992 as private company
 - Incorporated in terms of SA Companies Act No. 61 of 1973
 - SA Government sole shareholder
 - Listed Schedule 2 public entity to PFMA
 - Headquartered in Centurion, several subsidiaries
- Description of Business:
 - Technology based company
 - **Core:** aerospace, land systems and defence related business
 - **Key capabilities:** systems development and production



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Directors' Report (contd.)



- **Business Strategy:**
 - Separated from Armscor in 1992
 - Focus on manufacturing, sale of defence material, equipment
 - 10 years decline in real terms in local defence budget
 - SA increased foreign procurement
 - Result: unutilised capacity in local industry
- **Good progress on macro strategy (five pillars standing on foundation stone of *transformation* and *people*):**
 - Secure “privileged access” (to South Africa’s defence spend);
 - Engage state agencies;
 - Evaluate commercial viability (fix or exit) of business entities;
 - Create equity based relationships / formal alliance partners;
 - Raise productivity and capabilities to world-class standards.

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Directors' Report (contd.)



- Overview of Financial Performance:
 - Financial results:
 - Net loss: R1,377 million, improvement on prior year R1,561 million
 - Reduced turnover by R869 million due to lost markets, rescheduled orders
 - R515 million provision for contract risks
 - Restructuring provision R59 million
 - Low production in certain plants: under recovery of labour by R150 million
 - Adoption of International Financial Reporting Standards
 - Denel converted from SA GAAP to IFRS
 - Comprehensive financial clean-up
 - Recapitalisation
 - Company issued 447 394 324 ordinary Class “A” shares (R1.00 each)
 - Premium of R1,552.7 million to SA Government, for total of R2 billion
 - Percentage of actual costs to date

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Directors' Report (contd.)



- Overview of Financial Performance (contd.):
 - Provision for contract risks
 - Airbus Military R288 million
 - Contract costs on labour, raw materials, machine costs
 - Site restoration provision
 - Change in accounting policies
 - Revenue recognition on long-term contracts
 - Now based on pre-determined milestones



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Directors' Report (contd.)



- **Property, Plant and Equipment**
 - Significant impact of IFRS
 - Certain assets restated to fair value
 - Useful lives, residual values adjusted
- **Share Capital and Share Premium**
 - Directors no authority to issue share
 - Specific approval from Shareholder to issue shares as above
 - No change in authorized share capital
- **Dividends**
 - No dividends recommended for 2005/06



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Directors' Report (contd.)



- Non-core businesses:
 - Significant contributor to past losses
 - Progress in disposal:
 - Ariviakom (Pty) Ltd
 - Irencoplastics (Pty) Ltd
 - Dendustri (division)
 - Voltco (division)
 - Irencoplastics (Observer Technologies) – (division)
 - Others to follow in 2006/07 year
 - Also sale of vacant, unutilised land
- Borrowings:
 - Consist mainly of Corporate Bond R825 million
 - Matures 16 August 2007
 - Bears interest at fixed 12.8%
 - No restrictions on Directors r.e. borrowings



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Directors' Report (contd.)



- **Going Concern:**

- Losses due to core divisions operating at below break-even
- Divisions being re-engineered
- Cash flow problems
- Appropriateness of going concern based on:
 - Cash position, cash requirements to 12 months from balance sheet date, borrowing facilities, funding commitments by Shareholder
 - Other factors: implementation of strategy, Shareholder's view of Group as strategic asset, Shareholder commitment to preserve going concern, Government guarantees R800 million.

- **Human Resources:**

- Large scale retrenchment
- Negative staff morale
- Employees strongest asset
- Next year interventions to improve morale, productivity
- Special focus on technical skills, transformation.



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Directors' Report (contd.)



- **Public Finance Management Act (PFMA):**
 - Group internal audit integrated compliance with PFMA provisions
 - In future findings to be reported to Audit and Risk Committee
 - PFMA contains certain onerous requirements
 - Despite progress, company not fully compliant in certain sections (see e.g.. Shareholder Compact and Risk Management)
- **Companies Act:**
 - Directors confirm company lodged all returns as required.
 - Instances of non-compliance at subsidiary level:
 - Company registers not up to date
 - Annual returns not submitted
 - Year-ends not changed to that of Group
 - No Annual General Meetings held
 - No resolutions to approve financial statements
 - Board is rectifying situation



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Risk Management



- Integral part to generate shareholder value, enhance stakeholder interest
 - Objective: to manage risk of failure to achieve business objectives
 - On-going process to identify, manage, monitor risks
 - Management responsible for:
 - Continuous identification, assessment and response to risk
 - Board ultimately responsible for:
 - Group risk management system
 - Review of effectiveness of system
 - Audit & Risk Committee tasked with:
 - Oversight and monitoring of risk management process

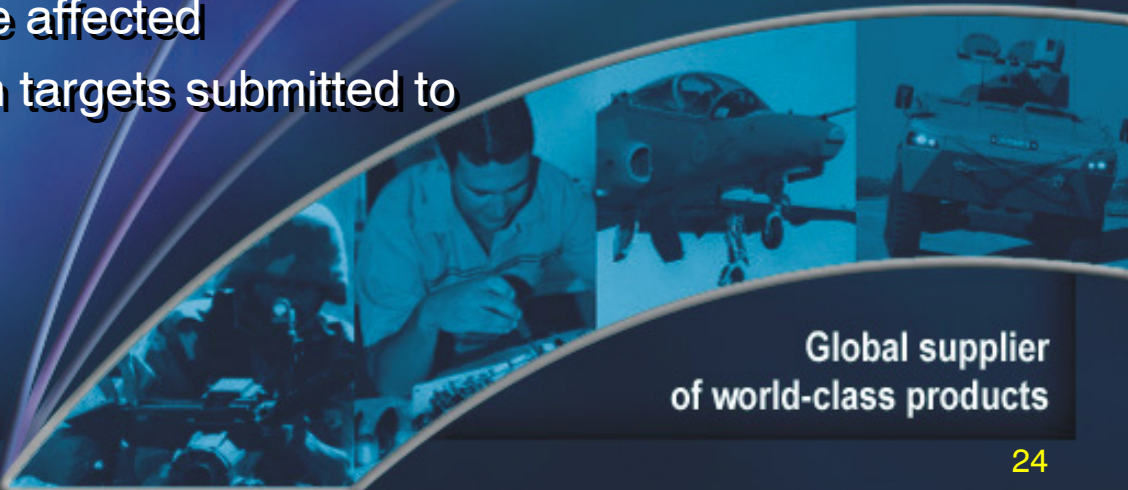


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Other Matters



- **Group Ethics Policy**
 - Commits Group to sound business practices, compliance with legislation
 - All employees to act with utmost good faith and integrity
- **Shareholders' Compact**
 - Compacts for 2005 and 2006 not finalized
 - Due to revision and implementation of strategy
 - Business currently in transformation period
 - Setting of targets were affected
 - Financial budgets with targets submitted to Executive Authority



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Income Statement -

- 31st March 2006

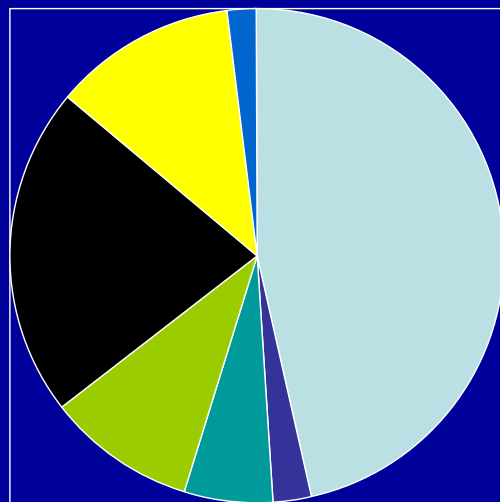


| Description | 31 March 2006 | 31 March 2005 |
|---|-------------------|-------------------|
| | Actual Rm | Actual Rm |
| Revenue | 2 730 | 3 611 |
| Gross (loss) profit | (160) | 132 |
| GP as % of revenue | (6%) | 4% |
| <i>Add back: Exceptional items</i> | <i>(655)</i> | <i>(862)</i> |
| <i>Gross profit before exceptional items</i> | <i>496</i> | <i>994</i> |
| <i>Gross profit before exceptional items as % of sales</i> | <i>18%</i> | <i>28%</i> |
| Other income | 204 | 111 |
| Operating costs | (1 155) | (1 557) |
| Net finance costs | (170) | (104) |
| | | - |
| Net loss for the year | (1 377) | (1 561) |
| | | |
| Cash utilised in operating activities | (1 132) | (276) |

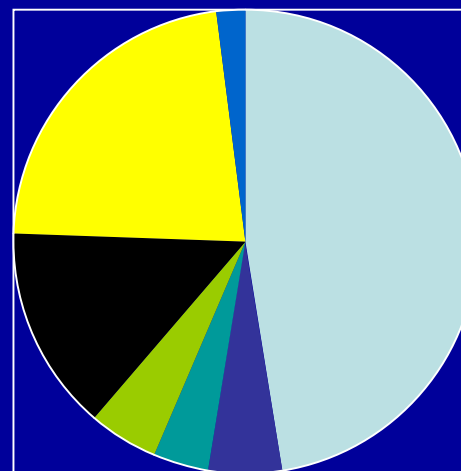
Sales Per Region



2005

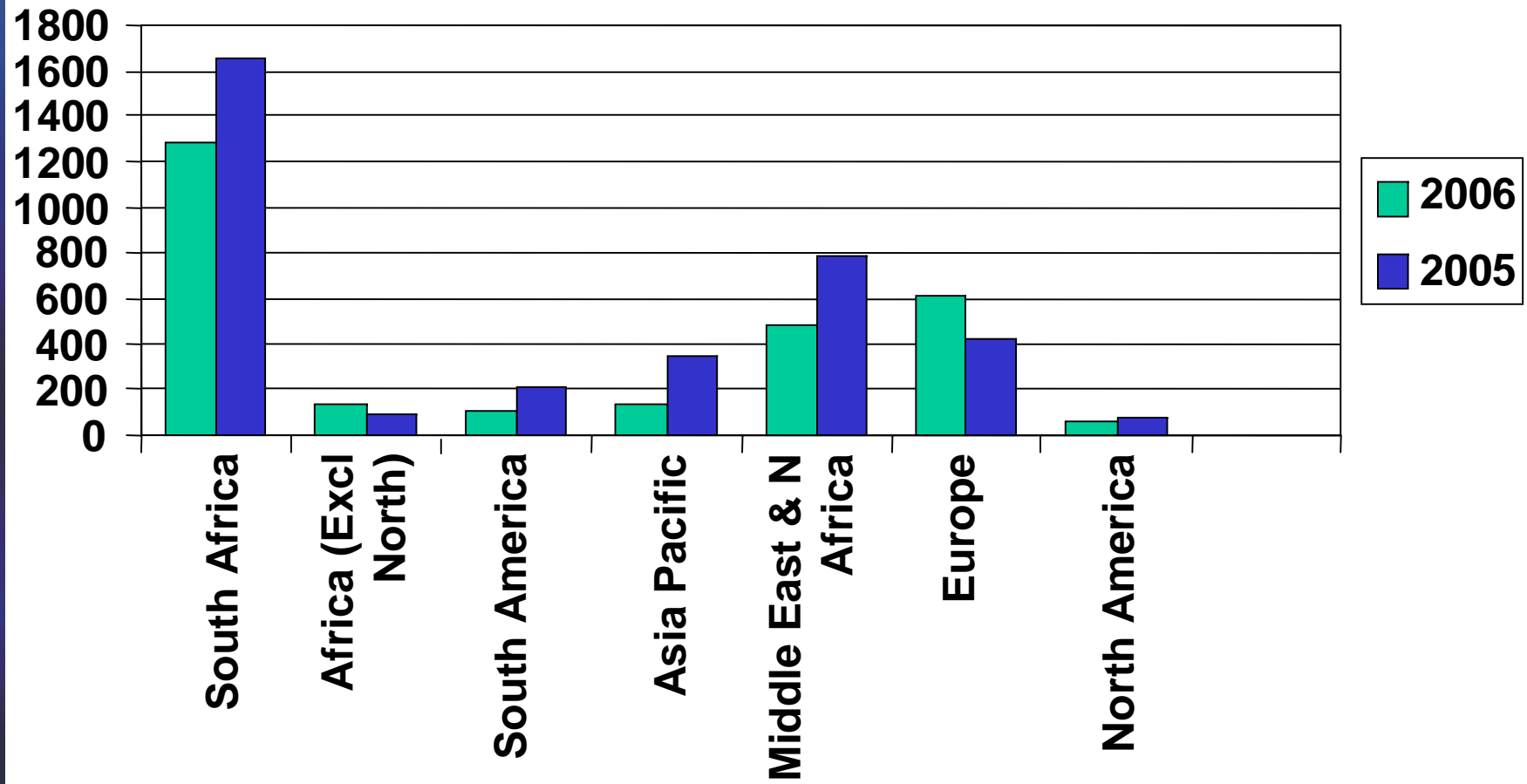


2006

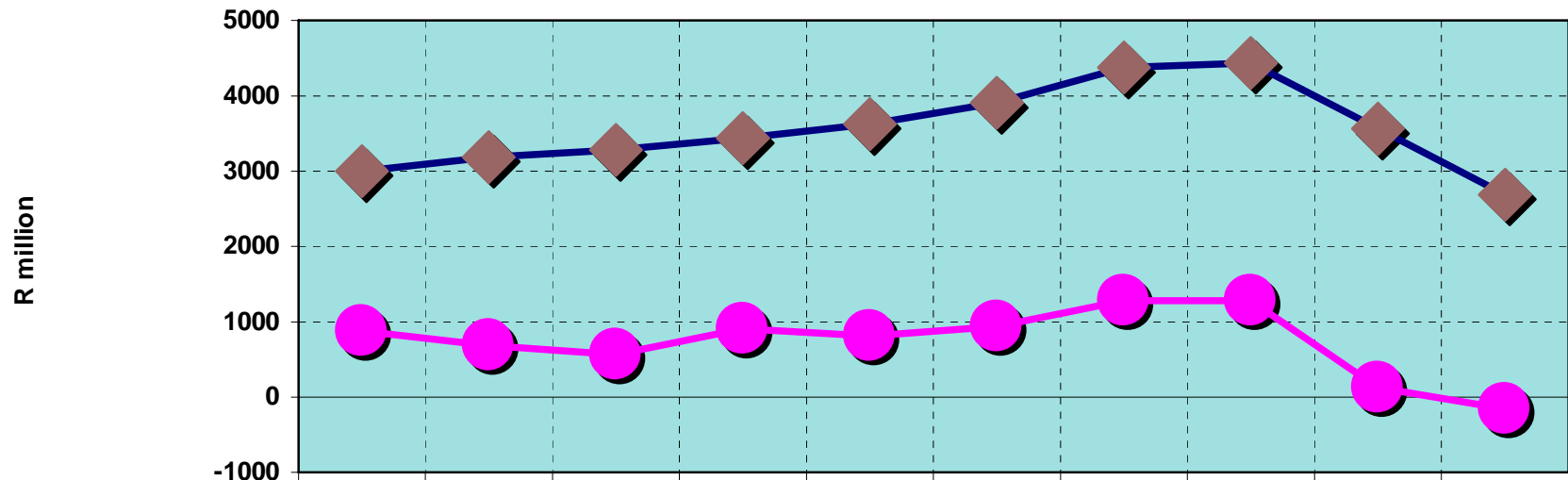


- | | |
|------------------------|-------------------------|
| South Africa | Africa (Ecxl. N Africa) |
| S America | Asia Pacific |
| Middle East & N Africa | Europe |
| N America | |

Sales Per Region

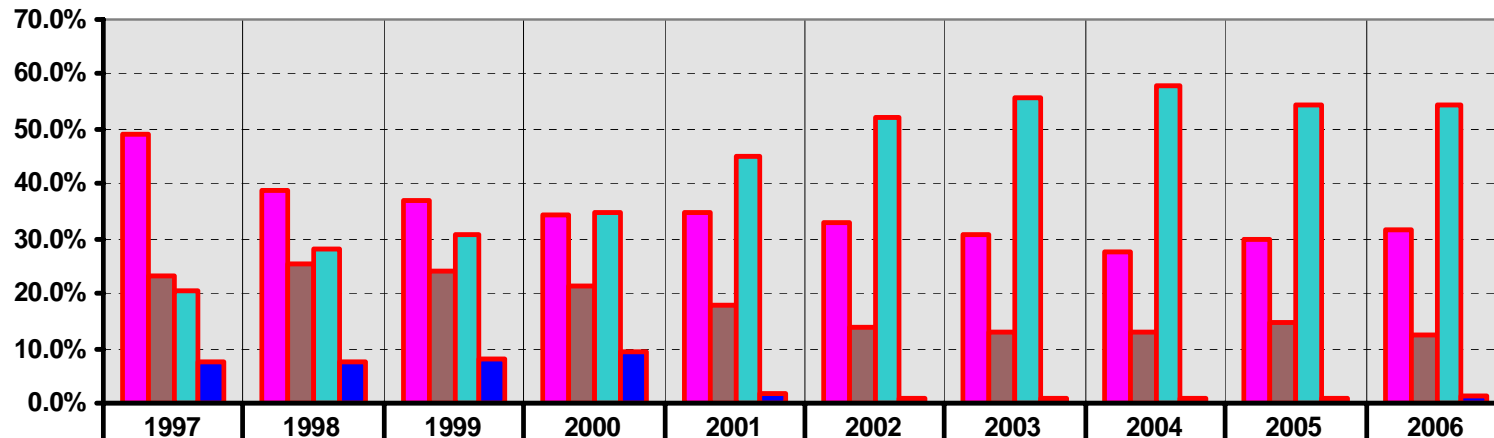


Group Gross Revenue and Gross Profit / Loss



| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---------------------|--------|--------|--------|--------|--------|--------|---------|---------|--------|---------|
| ◆ Gross revenue | 3013.2 | 3177.4 | 3271.8 | 3445.9 | 3621.1 | 3904.3 | 4372.4 | 4442.2 | 3611.0 | 2730.0 |
| ● Gross profit/loss | 873.7 | 700.0 | 578.0 | 917.6 | 825.9 | 945.1 | 1,276.3 | 1,287.3 | 132.0 | (159.5) |

Group Gross Revenue Composition (Percentage)



| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| ■ Military: local | 49.1% | 39.0% | 37.2% | 34.2% | 34.9% | 33.0% | 30.6% | 27.8% | 30.0% | 31.7% |
| ■ Commercial: local | 23.2% | 25.4% | 24.1% | 21.5% | 17.9% | 14.0% | 12.8% | 13.1% | 14.6% | 12.6% |
| ■ Exports | 20.3% | 28.1% | 30.7% | 34.8% | 45.2% | 52.0% | 55.6% | 58.1% | 54.5% | 54.3% |
| ■ Other | 7.4% | 7.5% | 8.1% | 9.5% | 2.0% | 0.9% | 1.1% | 1.0% | 0.9% | 1.5% |

Analysis of Total Costs



| Description | 31 March 2006 | 31 March 2005 | Movement | 31 March 2005 |
|--------------------------------|---------------|---------------|------------|---------------|
| | Actual Rm | Actual Rm | Rm | Actual Rm |
| Total Costs | 4018 | 4997 | 979 | 4997 |
| Cost of sales | 2863 | 3440 | 577 | 3440 |
| Operating costs | 1155 | 1557 | 402 | 1557 |
| Key Changes: | | | | 1 016 |
| Inventory purchases | 1164 | 1390 | 226 | |
| Staff costs –increased by 1.5% | 2047 | 2015 | | |
| Research and development costs | 154 | 207 | 53 | (16) |
| Impairment of assets | 16 | 200 | 184 | 1 732 |
| | | | | 2 888 |
| | | | | 677 |
| | | | | 622 |

Group Segment Report



| Description | Aerospace | | Land Systems | | Corporate and Non-cores | | Total after inter-group eliminations | |
|----------------------------|-------------------|-------------------|-------------------|-------------------|-------------------------|-------------------|--------------------------------------|-------------------|
| | 2006 <i>Rm</i> | 2005 <i>Rm</i> | 2006 <i>Rm</i> | 2005 <i>Rm</i> | 2006 <i>Rm</i> | 2005 <i>Rm</i> | 2006 <i>Rm</i> | 2005 <i>Rm</i> |
| Segment revenue | 1,855.9 | 2,200.4 | 1,106.4 | 1,675.6 | 311.5 | 414.3 | 2,703.1 | 3,572.1 |
| Segment result | (777.1) | (824.3) | (342.1) | (376.2) | (18.8) | (326.3) | (1,141.7) | (1,314.7) |
| Segment assets | 1,752.9 | 1,885.2 | 1,355.7 | 1,725.6 | 7,788.1 | 6,899.0 | 4,434.2 | 4,445.4 |
| Segment liabilities | 4,584.3 | 3,861.7 | 1,430.3 | 1,429.1 | 3,624.9 | 4,748.8 | 3,818.5 | 4,458.9 |
| Cash flows from: | | | | | | | | |
| Operating activities | (528.6) | 69.5 | (431.6) | (133.0) | (173.6) | (189.4) | (1,132.2) | (275.6) |
| Investing activities | (81.7) | (19.4) | (31.3) | (28.7) | 200.6 | (63.7) | 78.9 | (146.6) |
| Financing activities | 466.7 | 288.8 | 312.3 | 131.7 | 1,157.1 | 1,233.5 | 1,478.1 | 433.0 |
| Capital expenditure | (88.5) | (54.5) | (31.9) | (30.4) | (19.8) | (60.5) | (140.2) | (145.3) |

Balance Sheet

– 31st March 2006



| Description | 31 March 2006 | 31 March 2005 |
|---|---------------|---------------|
| | Actual Rm | Actual Rm |
| Non-current assets | 1 610 | 2 173 |
| Current assets | 2 649 | 2 410 |
| • <i>Debtors</i> | 807 | 919 |
| • <i>Inventories</i> | 985 | 1 016 |
| <i>Non-current assets held for sale</i> | 352 | 68 |
| Total assets | 4 611 | 4 651 |
| Capital and reserves | 607 | (16) |
| Non-current liabilities | 2 018 | 1 732 |
| Current liabilities | 1 958 | 2 888 |
| • <i>Trade and other payables</i> | 561 | 677 |
| • <i>Provisions</i> | 566 | 622 |
| Total equity and liabilities | 4 611 | 4 651 |

Cash Flow Before Financing Activities

– 31st March 2006



| Description | 31 March 2006 | 31 March 2005 |
|---|----------------|---------------|
| | Actual Rm | Actual Rm |
| Operating (loss) profit before change in net current assets | (903) | (332) |
| Change in net current assets | (46) | 178 |
| Cash (utilized in) generated from operations | (949) | (154) |
| Interest paid | (170) | (104) |
| Taxation paid | (14) | (18) |
| Cash utilised in operating activities | (1 132) | (276) |
| Cash generated from (utilised in) investment activities | 79 | (147) |
| Net cash utilised before financing | (1 053) | (422) |

Recapitalisation Requirements (Restructuring, Limited Exit and Investment)



| Investment Company | Potential Partners | 2006/7 | 2007/8 | 2008/9 | 2009/10 | 2010/11 | Total All Years | Accu Total |
|-------------------------|--------------------|-------------|-------------|------------|------------|-----------|-----------------|-------------|
| Sins of the past | | 1750 | 1216 | 598 | 125 | 0 | 3689 | 3689 |
| Aerostructures | Saab A | 482 | 245 | 0 | 0 | 0 | 727 | 4416 |
| Dynamics | Saab BD | 315 | 175 | 63 | 40 | 26 | 619 | 5035 |
| Dynamics | Debt | | 127 | 72 | 70 | 2 | 271 | |
| Optronics | Zeiss/Flir | 20 | 20 | 20 | 20 | 20 | 100 | 5135 |
| Logistic Support | SAT, Saab, E/C | 0 | 0 | 0 | 0 | 0 | 0 | 5135 |
| Munitions | TBD | 0 | 25 | 10 | 0 | 0 | 35 | 5170 |
| Integrated Systems | GRIDS/ ADS | 0 | 0 | 0 | 0 | 0 | 0 | 5170 |
| DLS Lyttelton | BAES | 0 | 0 | 0 | 0 | 0 | 0 | 5170 |
| Rooivalk | TBD | 0 | 0 | 0 | 0 | 0 | | 5170 |
| Total – All BU's | | 2567 | 1681 | 691 | 185 | 46 | 5170 | |

Recapitalisation Requirements

“Sins of the Past”



| Division/BU Restructuring | 2006/7 | 2007/8 | 2008/9 | 2009/10 | Total |
|---------------------------|-------------|-------------|------------|------------|-------------|
| Denel Corp | 547 | 825 | 0 | 0 | 1379 |
| Non-Core Proceeds | -447 | 0 | 0 | 0 | -450 |
| India Guarantee | 170 | 0 | 0 | 0 | 170 |
| Aviation | 803 | 0 | 0 | 0 | 803 |
| DAS Rooivalk | 65 | 300 | 250 | 0 | 615 |
| Munitions | 80 | 91 | 348 | 125 | 644 |
| LIW | 528 | 0 | 0 | 0 | 528 |
| Total | 1750 | 1216 | 598 | 125 | 3689 |

Denel's Funding Requirement



| DESCRIPTION | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | Total |
|--------------------------------------|-------|-------|-------|------|------|------|-------|
| Total Funding Requirement | 2,855 | 1,393 | 1,803 | 693 | 187 | 48 | |
| Funding: | | | | | | | |
| Corporate Bond | 825 | 825 | | | | | |
| External Short Term | 30 | 1 | 122 | 2 | 2 | 2 | |
| RECAPITALISATION Required | 2,000 | 567 | 1,681 | 691 | 185 | 46 | 5,170 |
| Share Capital | 2,000 | | | | | | 2,000 |
| Additional Recapitalisation Required | - | 567 | 1,681 | 691 | 185 | 46 | 3,170 |

Interim Funding :

Loan repaid in March 2006

1,515

Loan covered by Government Guarantee with additional interest implications

800

Total Number of Employees



| Description | 2006 | | 2005 | |
|----------------------------------|--------------|-------------|--------------|-------------|
| | Quantity | % | Quantity | % |
| TOTAL NUMBER OF EMPLOYEES | 8 120 | 100% | 9 369 | 100% |
| TOTAL NUMBER OF MANAGERS | 560 | 7% | 581 | 6% |
| White managers | 445 | 79% | 423 | 73% |
| Black managers | 115 | 21% | 158 | 27% |
| Male managers | 500 | 89% | 518 | 89% |
| Female managers | 60 | 11% | 63 | 11% |
| RACE | | | | |
| White employees | 4 266 | 53% | 4 673 | 51% |
| Black employees | 3 854 | 47% | 4 696 | 49% |
| GENDER | | | | |
| Male employees | 6 291 | 77% | 7 109 | 76% |
| Female employees | 1 829 | 23% | 2 260 | 24% |

Internal Bursars - 2006



| Field of study | African | | Coloured | | Asian | | White | | Total |
|-------------------|-----------|-----------|-----------|----------|-----------|----------|-----------|----------|------------|
| | Male | Female | Male | Female | Male | Female | Male | Female | |
| TOPP – CA (SA) | 3 | | 1 | | | | 1 | 1 | 6 |
| Aeronautical Eng. | | | | | | 1 | | | 1 |
| B Tech | 14 | 3 | 2 | | 3 | | 5 | | 27 |
| B Comm | 3 | 1 | 2 | 1 | | | 3 | | 10 |
| B Compt | 2 | | 1 | | | | 1 | 2 | 6 |
| B Eng | 1 | | | | 1 | | 1 | 1 | 4 |
| BSc | 3 | | 2 | | | | 2 | | 7 |
| Electr Eng | 1 | | | | 2 | | 3 | | 6 |
| Fasia France | 1 | | | | | | 2 | | 3 |
| M Eng | 1 | | | | 2 | | | | 3 |
| MBA | 2 | 1 | | | | | 1 | | 4 |
| Mechanical Eng | 4 | | | | 2 | | | | 6 |
| Project Man | 3 | | | | | | 1 | | 4 |
| Software Eng | | | | | | | 3 | | 3 |
| Various | 24 | 5 | 11 | 3 | 1 | 1 | 13 | 2 | 60 |
| TOTAL | 62 | 10 | 19 | 4 | 11 | 2 | 36 | 6 | 150 |

External Bursars - 2006



| Field of study | African | | Coloured | | Asian | | White | | Total |
|-----------------------|-----------|-----------|----------|----------|----------|----------|----------|----------|-----------|
| | Male | Female | Male | Female | Male | Female | Male | Female | |
| Aeronautical | 3 | 3 | | | 4 | 2 | | | 12 |
| Mechanical | 19 | 5 | | 1 | 1 | | 3 | 2 | 31 |
| Chemical | 5 | 2 | | | 1 | | 1 | | 9 |
| Industrial | 1 | | | | | | | 2 | 3 |
| Computer | | | | | | | 2 | 2 | 4 |
| BCom | | 1 | | | | | | | 1 |
| Electronic/Electrical | 26 | 2 | 1 | | | | 3 | 2 | 34 |
| TOTAL | 54 | 13 | 1 | 1 | 6 | 2 | 9 | 8 | 94 |

BEE Quantitative Achievements Report



| Description | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 |
|------------------|---------|---------|---------|---------|---------|
| Total spend (Rm) | 1 463 | 1 185 | 1 397 | 1 985 | 1 794 |
| BBBEE | 166 | 251 | 202 | 437 | 334 |
| % of total spend | 11,4% | 21,2% | 14,5% | 22,0% | 18,6% |

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Challenges Regarding BEE/SMME Suppliers



- Lack of skills impacted negatively on the growth of BEE companies
- Lack of access to capital promotes fronting
- Access to business management education
- Lack of exposure to business/industry requirements
- High concentration of SMMEs/BEE in the non-core areas
- Sustainability issues / Declining defence industry
- Small supplier base of direct materials suppliers

A collage of images in the bottom right corner, including a person working at a desk, a military vehicle, and a large industrial machine.

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BEE Qualitative Achievements



- Deployment of product/process specialist to train BEE entrepreneurs
- Active verification of authenticity of BEE credentials
- Advise both potential and current BEE companies of the opportunities available within Denel
- Punishment of fronting through withholding of Denel business



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Reportable Irregularities (1)

– Sec 45 of Audit Profession Act



- Management embarked on re-engineering of systems, processes and capabilities resulting in significant improvement in overall performance.
- However, still issues related to non-compliance with PFMA.
- Auditors reported to IRBA – 28 September 2006
- Board's response – 12 October 2006
- Board committed to turnaround of Group within properly governed environment, internal controls and compliance to PFMA, Treasury Regulations and Companies Act.

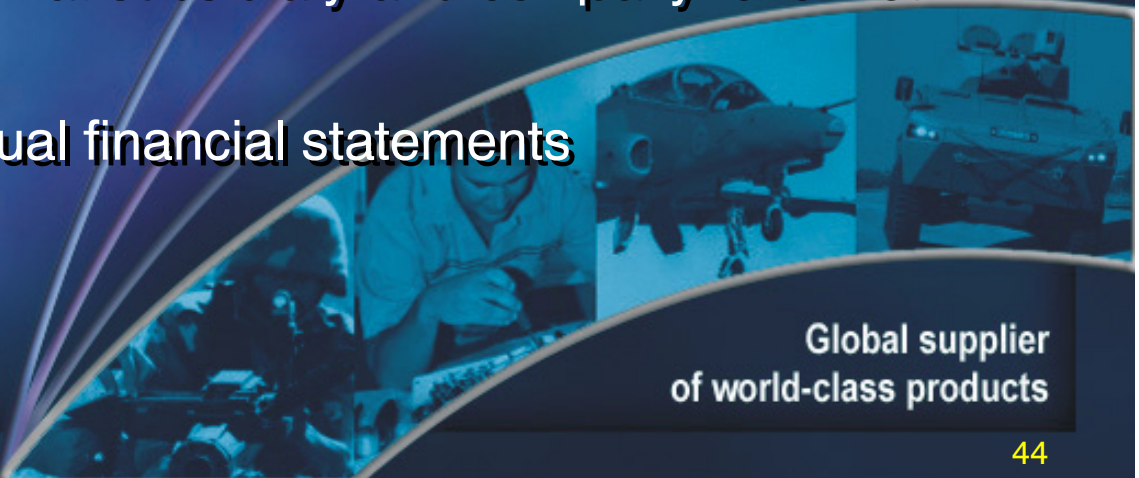
Global supplier
of world-class products

Reportable Irregularities (2)

– Sec 45 of Audit Profession Act



- Matters reported
 - Lack of effective system to prevent fruitless and wasteful expenditure
 - No Shareholders Compact concluded
 - Effective system of internal audit not maintained
 - Lack of accounting authority at two subsidiaries
 - Statutory documentation at subsidiary and company level not maintained
 - Late submission of annual financial statements



Global supplier
of world-class products

Reportable Irregularities (3)

– Sec 45 of Audit Profession Act



- Matters reported (contd.)
 - Risk management strategy and fraud prevention plan not fully implemented
 - Breakdown of internal control in some business entities
 - Report on disciplinary procedures or criminal charges due to financial misconduct outstanding
 - Remuneration of senior management not disclosed separately.



Global supplier
of world-class products

Risk Governance Summarised



Global supplier
of world-class products

Risk Mitigation Actions Taken



- Outsourced internal audit to PricewaterhouseCoopers
- Formal risk management processes/systems
- Monthly financial and operational performance review of each entity
- Establishment of quarterly Audit & Risk Committees at entity level, Internal and External Auditors present
- Monthly reporting to DPE and National Treasury on financial and operational performance
- Appointment of Chief Financial Officers at entity level
- Outsourcing the Fraud Hotline to KPMG
- Communicating the Materiality Framework to entities

A blue-tinted background image showing a car on the right and several people working together at a table on the left.

Global supplier
of world-class products

Internal Audit Background to Date (1)



1. Engagement letter signed, including terms and conditions
2. Transition phase complete:
 - Transfer of staff; PwC University; and development of balanced scorecard and SLA
3. Internal Audit Services Charter reviewed and updated
4. Risk workshops held with Executives and Management
5. Meetings with selected newco management and PwC US experts
6. Development of Internal Audit Plan (based on outputs of risk workshops) – done in consultation with Audit Committee Chair, CEO, CFO and External Auditors
7. 3-Year strategic plan and annual Internal Audit (IA) Plan approved

Global supplier
of world-class products

Internal Audit Background to Date (2)



8. Communication of IA Plan to Exco and newco senior management – includes information on communication protocol, timing of audits and audit teams.
9. Governance structure for audit sub-committees established – Internal Audit will table audit reports at this forum first before escalating to Audit Committee.
10. Operational Committee established to monitor Internal Audit performance.
11. Scheduled audits have commenced at newcos and Corporate Office.



Global supplier
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Denel Retirement Fund (1) DENRET



Defined contribution fund

- Total members 6715 (916 Pensioners)
- Sub-Committees of the Trust
 - Audit Committee
 - Communication Committee
 - Investment Committee
 - Management Committee
 - Risk Benefits Committee



Global supplier
of world-class products

Denel Retirement Fund (2)

DENRET



Key issues:

- Surplus Apportionment Exercise:
 - Payment of interest (cash or real investment returns) apportionment date until FSB approval of the scheme
 - Utilisation of contribution's holiday post 7 December 2001
 - Apportionment of new surplus after surplus apportionment date
 - Fund Structure and Flexible Contribution Rates



Global supplier
of world-class products

Denel Pension Fund (1) DENPEN



- Defined benefit fund- Financial position sound (126% fully funded)
- Total members 3201 (3145 Pensioners)
- Sub-Committees of the Board
 - Audit Committee
 - Investment Committee
 - Management Committee
 - Surplus Committee



Global supplier
of world-class products

Denel Pension Fund (2)

DENPEN



Key issues:

- **Surplus Apportionment Exercise**
 - Payment of interest (cash or real investment returns) from apportionment date until FSB approval
 - Utilisation of contribution's holiday post 7 December 2001
 - Future surplus policy to apportion new surplus
- **Finalisation of Asset Liability Matching Exercise Profile**
- **Redefining of Investment Strategy**



Global supplier
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Key 'Finance Related' Initiatives to Turnaround Denel (1)



- Appointment of new management teams(CEO's / CFO's)
- Focus on contract management
 - Viability, cash flow positive, de-risking practices, scope creep, regular monitoring, sales strategies
- Focus on working capital management:
 - Inventory management
 - Debtors management
- Focus on gross profit margins
 - True costs
 - Labour and overhead cost



Global supplier
of world-class products

Key 'Finance Related' Initiatives to Turnaround Denel (2)



- Improved integrity of financial information
 - IFRS implementation
 - Revenue recognition policy
 - Implementation of accounting disciplines to ensure accuracy, meeting deadlines, reliable information
 - Regular performance review meetings and remedial action taken
- Effective internal audit and risk management processes.



Global supplier
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Denel's Economic Context

SMME Development & Support

- LQS
- Aztec Components
- Ubambo Manufacturing
- Lerato Electronics
- Business Connection
- Black Ginger
- Compu Africa
- Matsema

Industry/SMME Support:

- Procurement: R2.1bn
- Local procurement: R1.2bn
- BEE/SMME spend: R256m

Advanced Engineering & Manufacturing

- Diffusion of new technologies, business processes & standards to the advanced manufacturing sector
- SA Large Telescope (SALT)
 - Pebble Bed Modular Reactor (PBMR)
 - Stellenbosch Satellite programme

Exports:

- Denel Exports: R2.1bn (~60% turnover)
- Denel's Net Foreign Exchange Earnings: R1.2bn

DENEL:

- 55% of local Defence Industry

Technological Contribution to RSA:

- Advanced manufacturing
- SMME Development/Support
- SADRI Development/Support/Cooperation

Development & Supply of Human Resources to Industry

- Attrition of Denel staff to defence & public/private industry (Telecoms, IT)
- Training and development initiatives (DCLD)
 - Project management
 - System engineers
 - Artisans
 - Youth development ...

Approx 8 500 Employees:

- Engineers (600)
- Scientists (75)
- Technicians (1300)
- Artisans/skilled production (4000)
- Support services & other

SADRI Development & Support

- Many companies were established around or in support of local development programs such as Rooivalk (e.g. ATE, AMS, Grintek, ADS, Aerosud, IST, ...)
- The SADRI now cooperates to supply local and international markets

Agenda



- Situation Analysis
- Strategy Imperatives
- Annual Report and Recapitalisation
- **Strategy Implementation Process & Status**
- Transformation
- Non-Core Disposal

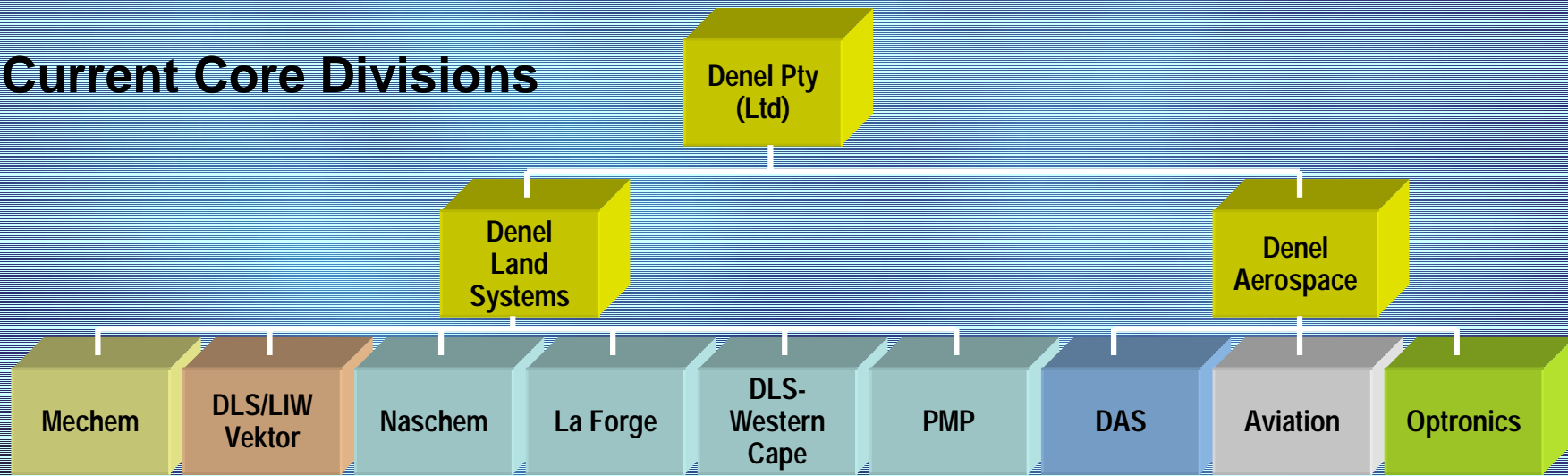


Global supplier
of world-class products

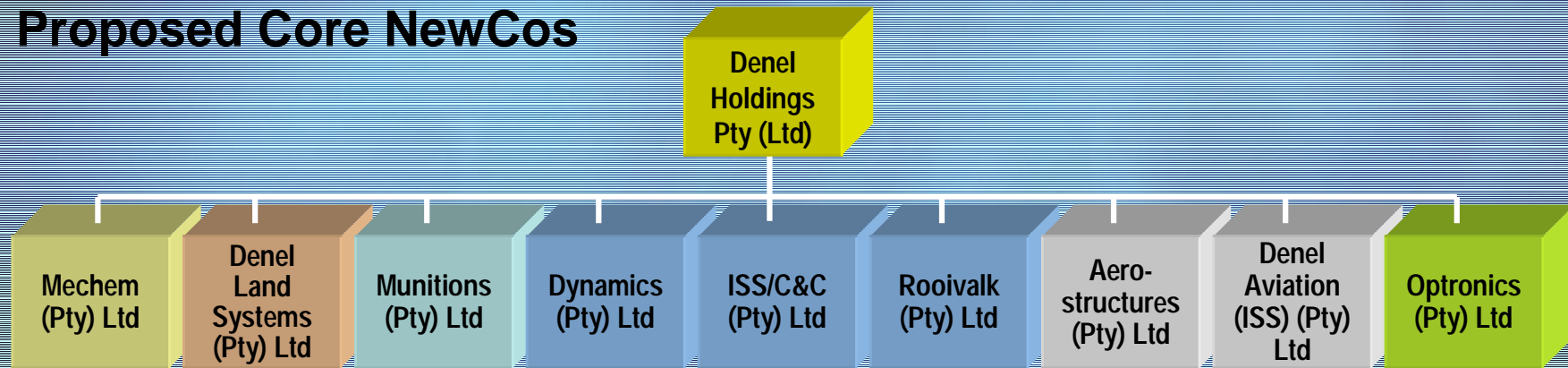
Structures



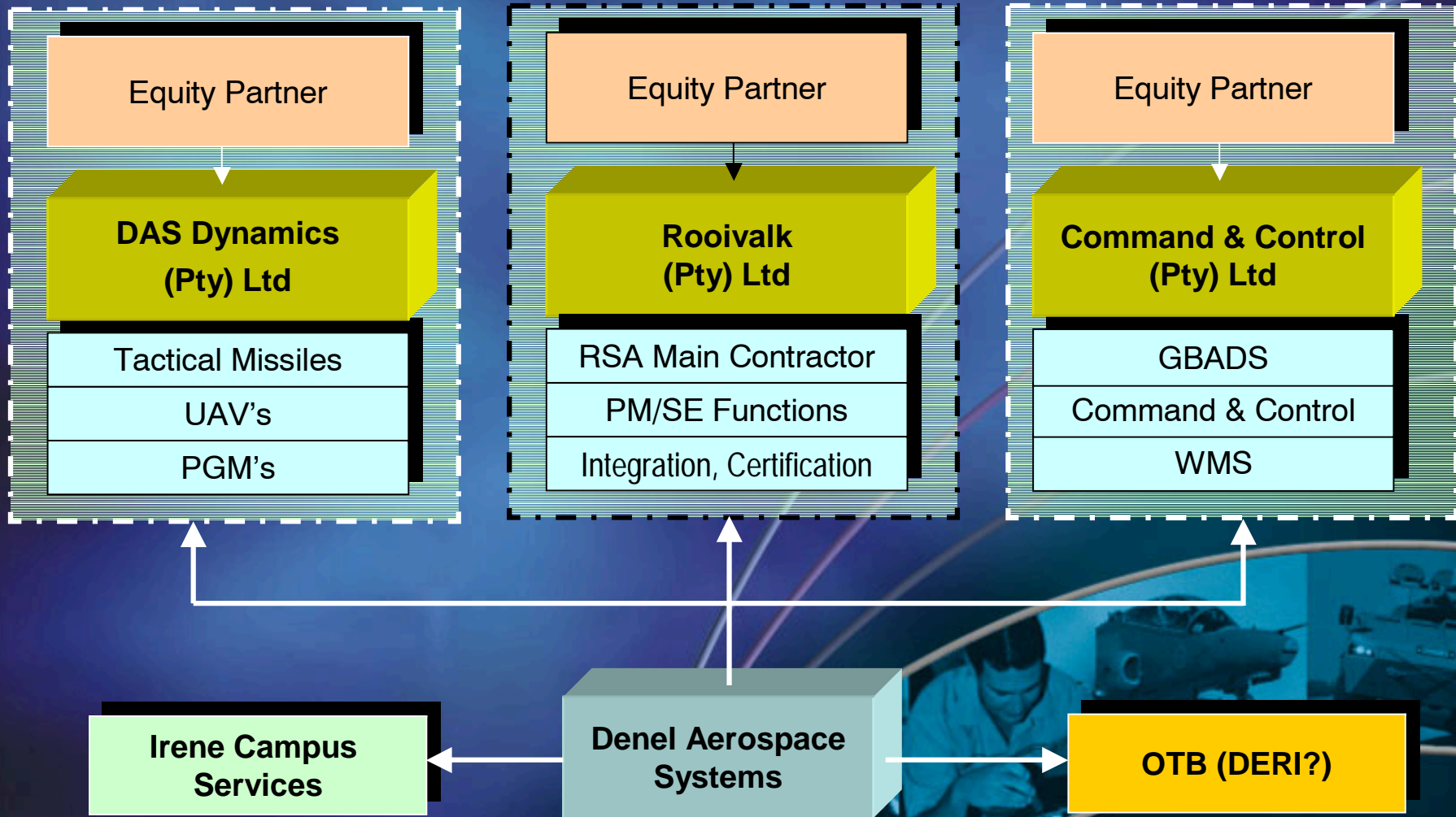
Current Core Divisions



Proposed Core NewCos



Strategic Roadmap: DAS



Dynamics NewCo (1)

A niche global competitor and local technology provider in the areas of tactical missiles, guided weapons and UAV systems



A-Darter Air-to-Air Missile



Ingwe & Mokopa Anti-Armour Missiles



Umkhonto Surface-to-Air Missile



Raptor Stand-off Weapon



Seeker UAV Surveillance System



Skua High Speed Target Drone



Bateleur Surveillance UAV

Dynamics NewCo (2)



A niche global competitor and local technology provider in the areas of tactical missiles, guided weapons and UAV systems

| Item | Notes/Status | Plan % | Status % | Target |
|---|---|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | Ongoing |
| | Performance reviews | ✓ | ✓ | Monthly |
| | Establish Dynamics NewCo | ✓ | 70% | Apr 07 |
| Engage State Agencies / Privileged Access | Business case under review by stakeholders – strategic entity | ✓ | 50 % | Nov 06 |
| Equity Partnerships & Alliances | Industry consolidation discussions in process | ✓ | 30% | Apr 07 |

| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|

Global supplier of world-class products

Command & Control NewCo (1)



A local main contractor for integrated level 5 air defence systems,
and a specialized local and international supplier of C3 products with
GBADS as flagship programme



GBADS – Ground-Based Air Defence System



**Weapons
Management System**

Global supplier
of world-class products

Command & Control NewCo (2)



A local main contractor for integrated level 5 air defence systems, and a specialized local and international supplier of C3 products with GBADS as flagship programme

| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | Ongoing |
| | Performance reviews | ✓ | ✓ | Monthly |
| Engage State Agencies / Privileged Access | Business case under review | ✓ | 50 % | Nov 06 |
| | Ongoing discussions with Government – strategic entity | | | Ongoing |
| Equity Partnerships & Alliances | Industry consolidation discussions in process | ✓ | 70% | Mar 07 |
| | MOU's established with major industry players | ✓ | 30% | Apr 07 |

| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|

Global supplier of world-class products

Rooivalk NewCo (1)



The main contractor for the SAAF Rooivalk Attack Helicopter conducting programme and contract management along with system level engineering



Rooivalk NewCo (2)



The main contractor for the SAAF Rooivalk Attack Helicopter conducting programme and contract management along with system level engineering

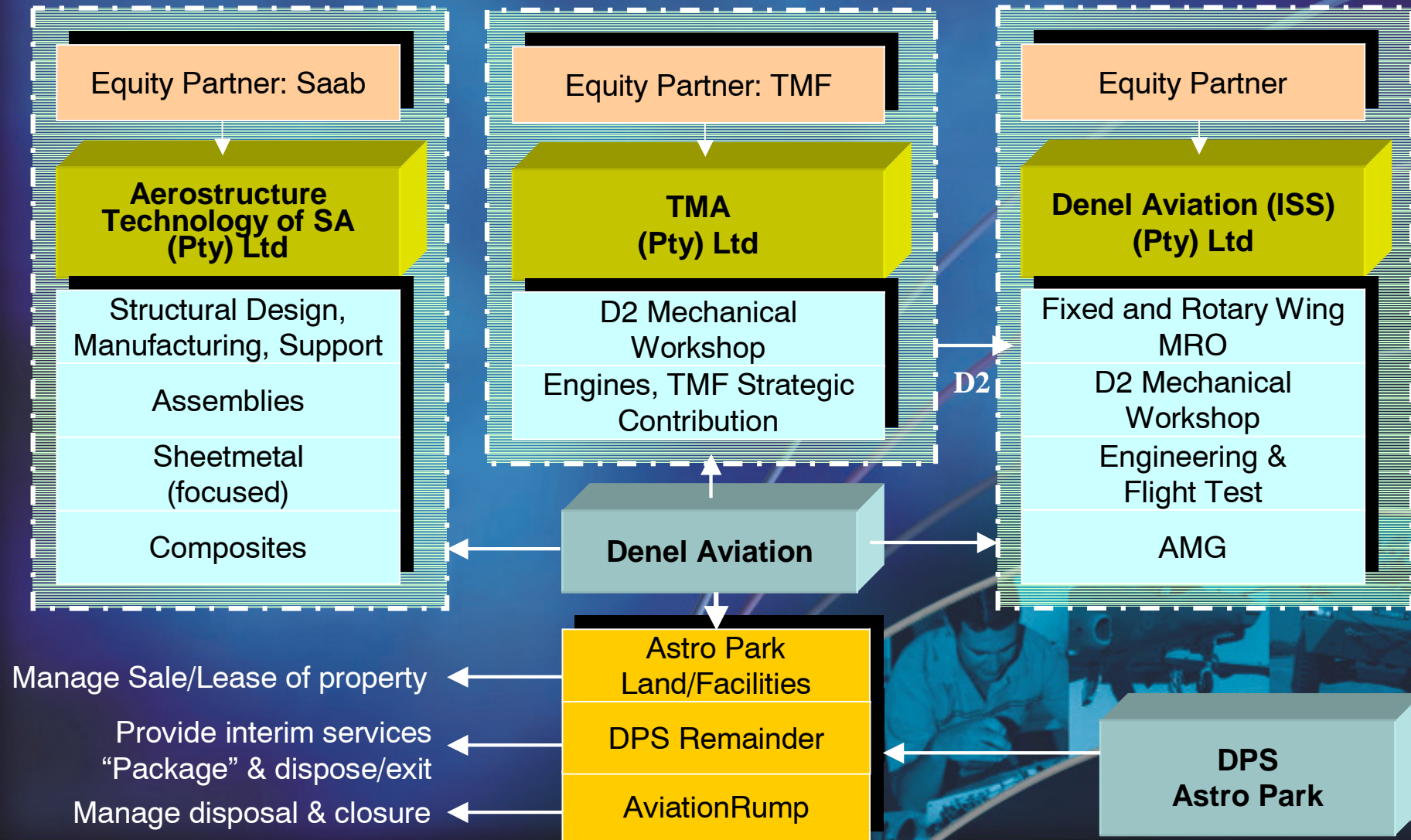
| Item | Notes/Status | Plan % | Status % | Target |
|---|---|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Business based on SAAF Rooivalk | ✓ | ✓ | Ongoing |
| | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | |
| | Performance reviews | ✓ | ✓ | Monthly |
| | NewCo pending Turkey outcome | ✓ | 50% | Apr 07 |
| Engage State Agencies / Privileged Access | Deployment of SAAF Rooivalk | ✓ | 70% | Sep 07 |
| | Excellent Government agencies, SAAF and industry support on Turkey bid. Best and final offer submitted. Turkey decision | ✓ | 80% | Nov 06 |
| | | ✓ | | Oct 06 |
| Equity Partnerships & Alliances | Strategic options dependent on outcome of Turkey bid | ✓ | 30% | Apr 07 |
| | Critical supplier discussions ongoing | ✓ | | Ongoing |
| | Good industry participation on execution of SAAF Rooivalk programme | ✓ | 70% | Ongoing |

As per plan

Pending/In Process

Risk Item

Strategic Roadmap: Denel Aviation, TMA, DPS, Astro Park



Denel Aviation (ISS) NewCo (1)



A service provider leveraging its strategic SAAF business to support local & selected international rotary & fixed-wing aircraft markets in the provision of MRO services

Rotary and
Fixed Wing
Aircraft
Maintenance



Aircraft Component
Maintenance
and
Engineering Support
(& Manpower Support)



Global supplier
of world-class products

Denel Aviation (ISS) NewCo (2)



A service provider leveraging its strategic SAAF business to support local & selected international rotary & fixed-wing aircraft markets in the provision of MRO services

| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | Ongoing |
| | Performance reviews | ✓ | ✓ | Monthly |
| | Strategic options for Fixed Wing maintenance ongoing | ✓ | 50% | Dec 06 |
| | New CEO/CFO appointed | ✓ | 100% | Oct 06 |
| Engage State Agencies / Privileged Access | SAAF Rotary Wing strategic planning framework | ✓ | 100% | Aug 07 |
| | Oryx upgrade (Drummer phase 1) contracted | ✓ | 80% | Jun 06 |
| | ACSA property negotiations | ✓ | 80% | Jan 07 |
| | | | | |
| Equity Partnerships & Alliances | Critical supplier discussions ongoing | ✓ | 70% | Ongoing |
| | D2 Mechanical workshop accreditation | ✓ | 80% | Dec 06 |

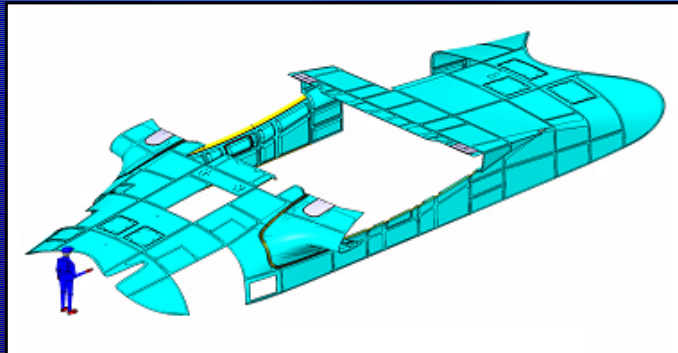
| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|

Global supplier of world-class products

Aerostructure NewCo (1)



An aerostructures facility, in cooperation with suppliers of aircraft such as Airbus and Boeing, which designs, manufactures, and assembles composites and metallic aircraft subsystem structures



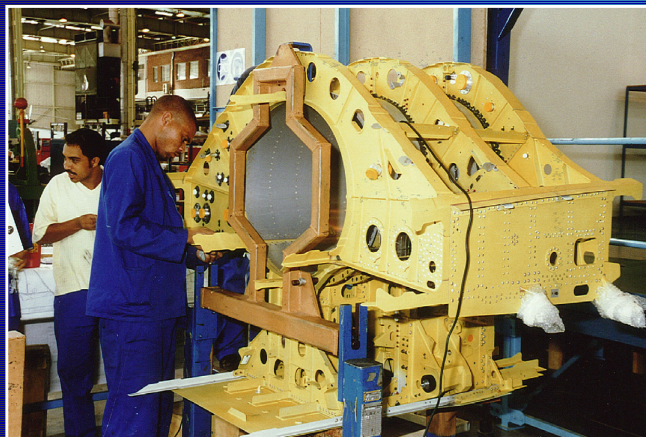
A400M Wing to Fuselage Fairing



A400M- Top Shells



Hawk - Flap



Gripen – Main Landing Gear Unit



A109 Manufacturing & Assembly

Global supplier
of world-class products

Aerostructure NewCo (2)



An aerostructures facility, in cooperation with suppliers of aircraft such as Airbus and Boeing, which designs, manufactures, and assembles composites and metallic aircraft subsystem structures

| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | Ongoing |
| | Performance reviews | ✓ | ✓ | Monthly |
| | Saab management team installed in key positions | ✓ | 100% | Aug 06 |
| | Lean manufacturing implementation | 80% | 20% | Mar 08 |
| | Capital investment plan | ✓ | 100% | |
| Engage State Agencies / Privileged Access | Government Advanced Manufacturing Technology workgroups | ✓ | 100% | Ongoing |
| Equity Partnerships & Alliances | Heads of Agreement signed | ✓ | 100% | Dec 06 |
| | Competition Commission approval | ✓ | 100% | |
| | Finalise transaction documents | ✓ | 80% | |

As per plan

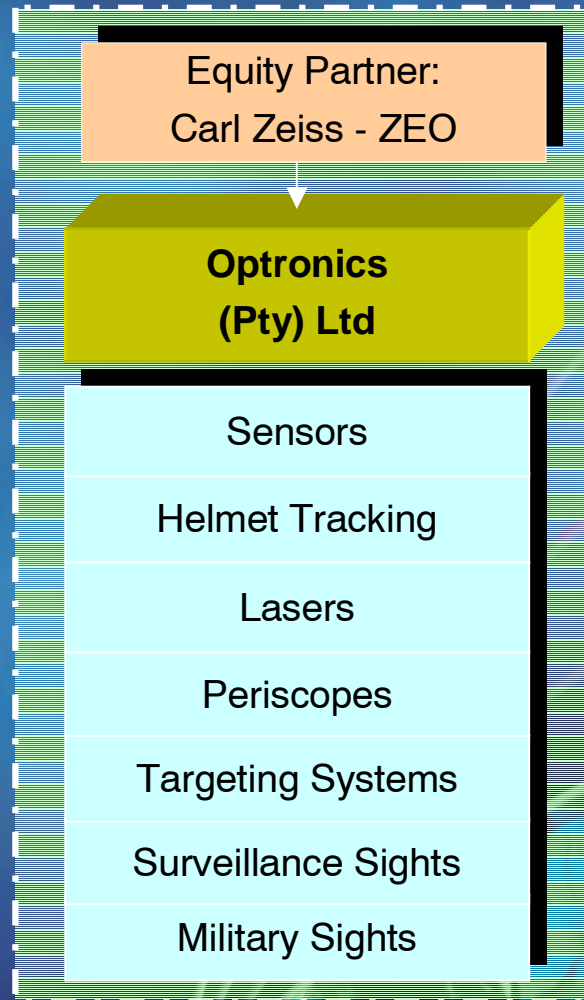
Pending/In Process

Risk Item

Global supplier of world-class products

Strategic Roadmap

Optronics



Global supplier
of world-class products

Optronics NewCo (1)



A global supplier, leveraging its expertise in optronics products (sensors, helmet tracking, lasers, periscopes, targeting & surveillance systems & sighting systems)



Periscope Systems



Sighting Systems



Thermal Imager – 3 to 5 μ m



BRITE Star



LH40 Laser Range Finder

Global supplier
of world-class products

Optronics NewCo (2)



A global supplier, leveraging its expertise in Optronics products (sensors, helmet tracking, lasers, periscopes, targeting & surveillance systems & sighting systems)

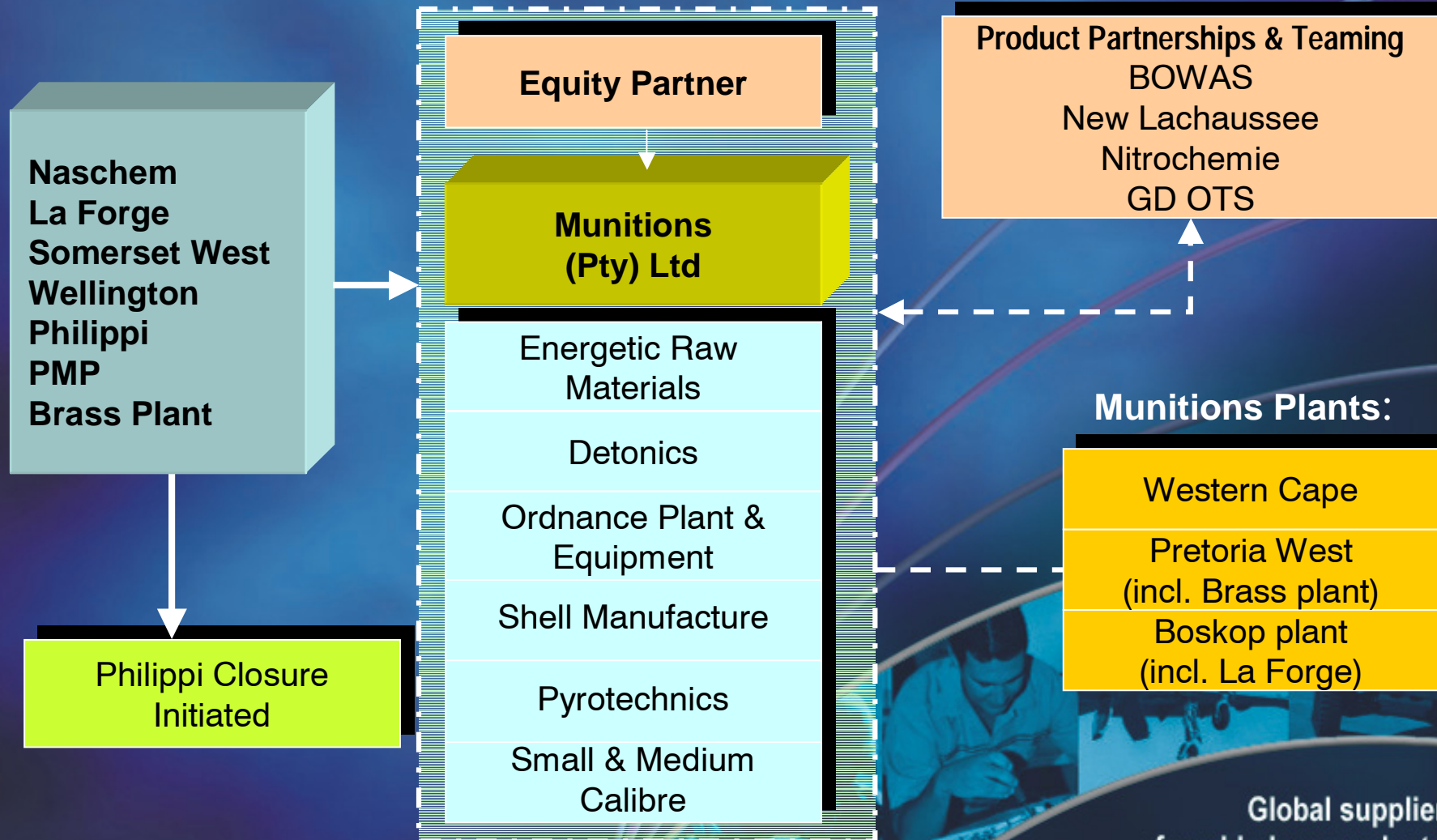
| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Large orders delayed resulting in Section 189 retrenchments & revised sales | ✓ | ✓ | Aug 06 |
| | Performance reviews | ✓ | 80% | Monthly |
| | NewCo establishment | ✓ | 80% | Nov 06 |
| | New CFO appointed | ✓ | 100% | Jul 06 |
| | Efficiency improvement plan and consolidation of operations through equity partner support | 80% | 35% | Mar 07 |
| Engage State Agencies / Privileged Access | Long-term security service acquisition framework discussions | ✓ | 80% | Nov 06 |
| Equity Partnerships & Alliances | Term Sheet signed | ✓ | 100% | Sept 06 |
| | Finalise transaction documents | ✓ | 40% | Feb 07 |

| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|

Global supplier of world-class products

Strategic Roadmap

Munitions



Global supplier
of world-class products

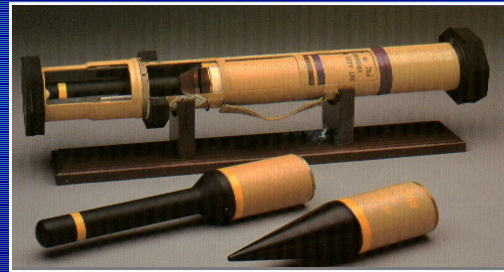
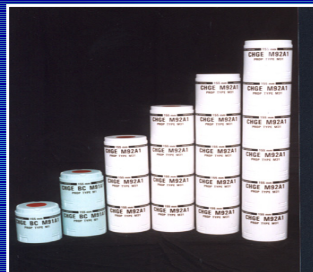
Munitions NewCo (1)



An integrated supplier of selected munitions (artillery ammunition, mortars, bombs, large & medium calibre ammunition pyrotechnics; missile motors & warheads) to local & international customers



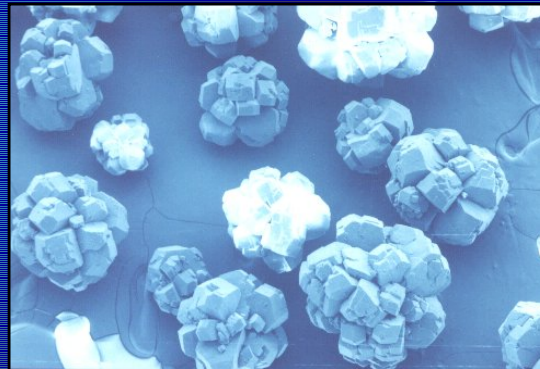
Artillery Propulsion



Rocket & Missile Subsystems



Propellants for Small Calibre & Power Cartridges



Energetic Raw Materials



Power Cartridges

Global supplier
of world-class products

Munitions NewCo (2)



An integrated supplier of selected munitions (artillery ammunition, mortars, bombs, large & medium calibre ammunition pyrotechnics; missile motors & warheads) to local & international customers

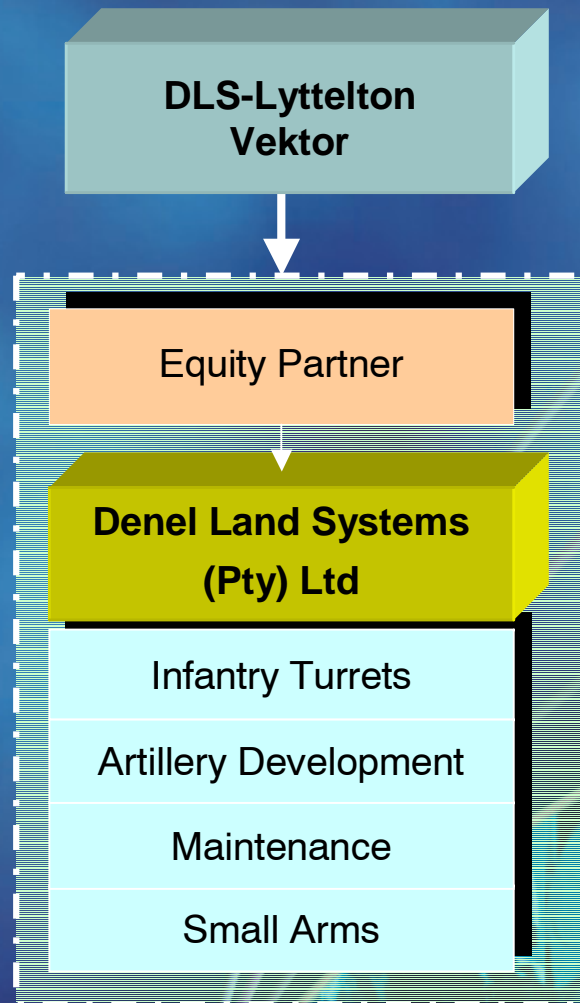
| Item | Notes/Status | Plan % | Status % | Target |
|---|---|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Minimum R1.15bn sustainable turnover | ✓ | ✓ | Mar 07 |
| | Performance reviews | ✓ | ✓ | Monthly |
| | Consolidated management | ✓ | 80% | Nov 06 |
| | Relocation of Philippi operations | ✓ | 10% | 2010 |
| | NewCo establishment pending consolidation and achievement of turnover targets | ✓ | 10% | 2008 |
| | New CEO and CFO appointed | ✓ | 100% | Dec 06 |
| | Efficiency improvement plan | ✓ | 60% | Mar 07 |
| Engage State Agencies / Privileged Access | Part of Government workgroup review as strategic SANDF supplier. Require ongoing support. | ✓ | 80% | Ongoing |
| Equity Partnerships & Alliances | Partner identification ongoing | ✓ | 10% | Ongoing |

| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|

Global supplier of world-class products

Strategic Roadmap

Denel Land Systems



Global supplier
of world-class products

Denel Land Systems NewCo (1)



Denel Land Systems is a consolidated, project based design & development house for combat turrets, artillery development, maintenance and upgrades and smallarms



G6 SP, 155mm Artillery



New Generation - Infantry Combat Vehicle



5.56 & 7.62 Light Machineguns



G5-52, 155mm Artillery



Global supplier
of world-class products

Denel Land Systems NewCo (2)



Denel Land Systems is a consolidated, project based design & development house for combat turrets, artillery development, maintenance and upgrades & smallarms

| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Turnover de-risked, efficiencies identified, costs reduced | ✓ | ✓ | Ongoing |
| | Performance reviews | ✓ | ✓ | Monthly |
| | Establish DLS NewCo | ✓ | 70% | Apr 07 |
| | Optimise site utilisation | ✓ | 70% | Mar 07 |
| Engage State Agencies / Privileged Access | Fast tracking SANDF programmes | ✓ | 90% | Ongoing |
| Equity Partnerships & Alliances | Synergy identification & due diligence completed | ✓ | 90% | Ongoing |
| | Transaction details under discussion | | 20% | Dec 06 |

As per plan

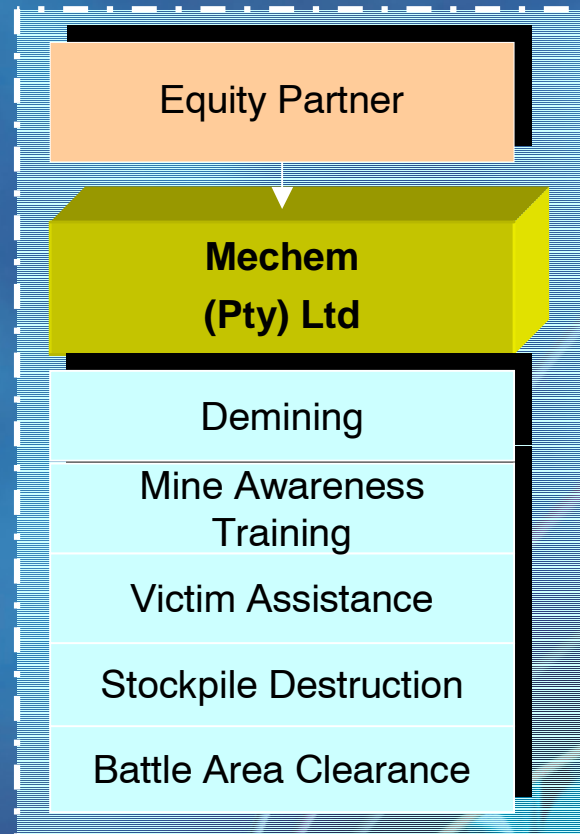
Pending/In Process

Risk Item

Global supplier of world-class products

Strategic Roadmap

Mechem



Global supplier
of world-class products

Mechem NewCo (1)



Mechem is a global leader in cost effective mine action, including demining, mine awareness training, victim assistance, stockpile destruction, clearance of battle areas & unexploded ordnance



Global supplier
of world-class products

Mechem NewCo (2)



Mechem is a global leader in cost effective mine action, including demining, mine awareness training, victim assistance, stockpile destruction, clearance of battle areas & unexploded ordnance

| Item | Notes/Status | Plan % | Status % | Target |
|---|--|--------|----------|---------|
| Commercial viability/ Raise Capabilities & Productivity | Performance Reviews | ✓ | ✓ | Monthly |
| | Establish NewCo | ✓ | 70% | Dec 06 |
| Engage State Agencies / Privileged Access | Non-strategic | | | |
| Equity Partnerships & Alliances | To be investigated after NewCo establishment | ✓ | 5% | Mar 07 |

| | | |
|-------------|--------------------|-----------|
| As per plan | Pending/In Process | Risk Item |
|-------------|--------------------|-----------|



Global supplier of world-class products



Denel Holdings (Pty) Ltd

**Aerostructures
(Pty) Ltd**

Design, manufacture and assembly of aircraft subsystem structures

**Denel Aviation
(ISS)
(Pty) Ltd**

Aircraft maintenance organisation to local & international clients

**Dynamics
(Pty) Ltd**

Design & manufacture of missiles, guided weapons and UAVs

**TMA
(Pty) Ltd**

Manufacturing and product support of aircraft engines

**Mechem
(Pty) Ltd**

Mine action, including demining, awareness training, & stockpile destruction

**Optronics
(Pty) Ltd**

Design & manufacture of electro-optical products & systems

**Denel Land
Systems
(Pty) Ltd**

Design & manufacture of combat turrets, artillery & smallarms

**Munitions
(Pty) Ltd**

Supplier of large & medium calibre munitions, & missile motors & warheads)

**Rooivalk
(Pty) Ltd**

System level engineering & contract management for the SAAF Rooivalk Attack Helicopter

**Command &
Control
(Pty) Ltd**

Main contractor for integrated level 5 air defence system, & supplier of C3 products

Agenda



- Situation Analysis
- Strategy Imperatives
- Annual Report and Recapitalisation
- Strategy Implementation Process & Status
- Transformation
- Non-Core Disposal



Global supplier
of world-class products

Transformation (1)



Objective: Organisational Effectiveness

Transform our people into a motivated, innovative and empowered workforce with a commercial and performance-based mindset within a truly representative and diverse environment

Diversity

- Race
- Gender
- Age
- Disability

Skills Retention & Dev

- Technical career paths
- Leadership development
- Succession planning
- Motivated personnel

Culture

- Performance culture
- Commercial mindset
- Diversity tolerance

Process

- Situation analysis (internal situation versus external benchmarks and criteria)
- Identify transformation goals & objectives
- Formulate & implement action plan to address shortcomings within an aggressive timeframe

Organisational Climate Survey – foundation for diversity initiatives
Preparation for performance management and reward system, bursary and GDP proposals

Transformation (2)



- **Organisational Climate Survey: September 2006**
 - **Main Objectives:**
 - Clear recommendations for transformation and diversity management
 - Alignment of the organisational culture with the new business strategy
 - **Findings:**
 - Questionnaire response rate: 45% and representative
 - Overall results achieved were generally negative: the Culture Index achieved was 43% (the norm being 50%)
 - Weakest area: Performance Management
 - Strongest area: Information & Participation
 - **Next Steps:**
 - Feedback of results to all employees
 - Review, implement and manage comprehensive Action Plans



Global supplier
of world-class products

Agenda



- Situation Analysis
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Global supplier
of world-class products

Non-Core Disposal



| Entity | Shareholding | Expected date of completion | Current status |
|--------------------------------|---------------|-----------------------------|--|
| Ariviakom (Pty) Ltd | 22.98% | 27 Feb 2006 | Payment received |
| SPP (Pty) Ltd | 100% | End October 2006 | Approved by Board. PFMA approval received Contract signed (deposit received) |
| Irenco (Observer Technologies) | Business unit | 2 June 2006 | Payment received |
| Voltco | Business unit | 18 April 2006 | Payment received |
| Bonaero Park (Pty) Ltd | 100% | End February 2007 | PFMA approval received. Contract signed on 31 March 2006. Eight of the thirteen properties have been transferred |
| Dendustri | Division | 24 May 2006 | Payment received |
| Cosource (Pty) Ltd | 51,7% | End December 2006 | Revised transaction presented to Board/Minister. PFMA approval received |
| Irenco Plastics (Pty) Ltd | 100% | Nov 2005 | Completed Retention money received |

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of world-class products



Thank You

