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Denel Annual Report 2004

DENEL

Global suppliers of world-class products

Annual Report 2004

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GRAPHICOR 30858

OUR PURPOSE

To be the leading South African defence company, supplying systems, products and services in selected niche areas to the domestic security services and to customers in global markets.

To be a prime contractor and systems integrator in selected areas.

To be a guardian of strategic technologies in our sector and a catalyst in South Africa for the development of future technologies.

To grow and operate profitably to provide jobs, to develop our people, and to provide training for others where we have the capacity.

OUR VALUES

SHARED VALUES

Customer focus	Innovation	Initiative	Integrity

TEAM VALUES

Denel is a market and people driven company.

Employees/colleagues at all levels working together as a team are the key to Denel's success. The following values will guide our decisions and behaviour:

- Placing customers first
  We always give customers the highest priority and encourage lasting relationships. We deliver quality products and services and honour our commitments.

- Innovation
  We seek new ideas and encourage continuous personal growth and improvement in everything we do in order to remain competitive and create value.

- Initiative
  We take calculated risks, make things happen, are creatively imaginative and bold.

- Integrity
  We are honest and fair in all our interactions, respect all people and embrace diversity. We endeavour to earn the confidence and respect of all stakeholders.

OUR BUSINESS

Denel was incorporated as a private company in April 1992 when it separated from Armscor, now the procurement division of the South African National Defence Force (SANDF). The industrial and manufacturing activities of Armscor were integrated into Denel. Denel is a business, operating for profit, not a government agency, although the Board of Directors is appointed by the Minister of Public Enterprises.

Denel is incorporated in terms of the Companies Act with the State as sole shareholder.

CORPORATE PROFILE

Number of employees: 10 925

- White 48,4%
- Black 51,6%
- Women 25,6%
- Black management – up from 35 to 65 in one year

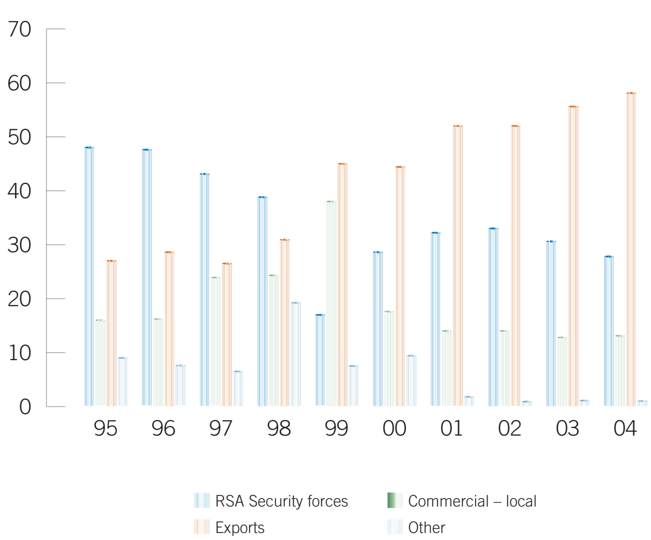
KEY BUSINESS MARKETS

- USA
- Europe
- Middle East
- Asia
- Africa

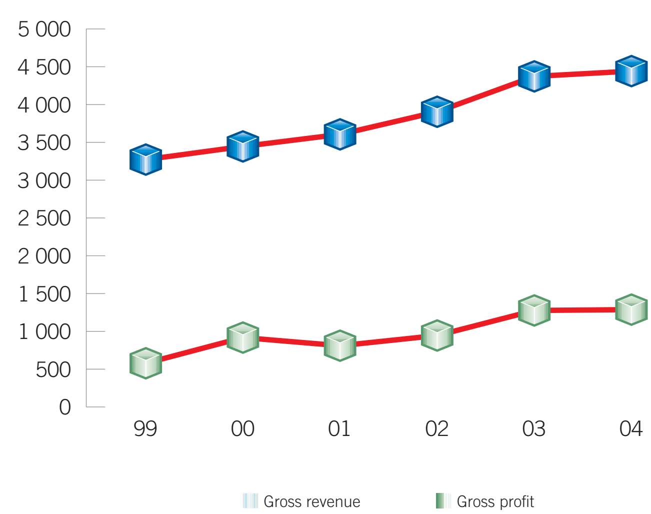
KEY BUSINESS OBJECTIVES FOR 2003/4

- Growth – ensure long-term growth in shareholder value and increase market share
- Technology – stay in the forefront of technology in areas of focus
- Customers – guarantee customer satisfaction through value for money, quality and service
- People – increase productivity and develop opportunities through improved training, development, communication and empowerment
- Transformation – to become a transformed company, representative of all South Africa's people

GROSS REVENUE COMPOSITION (%)

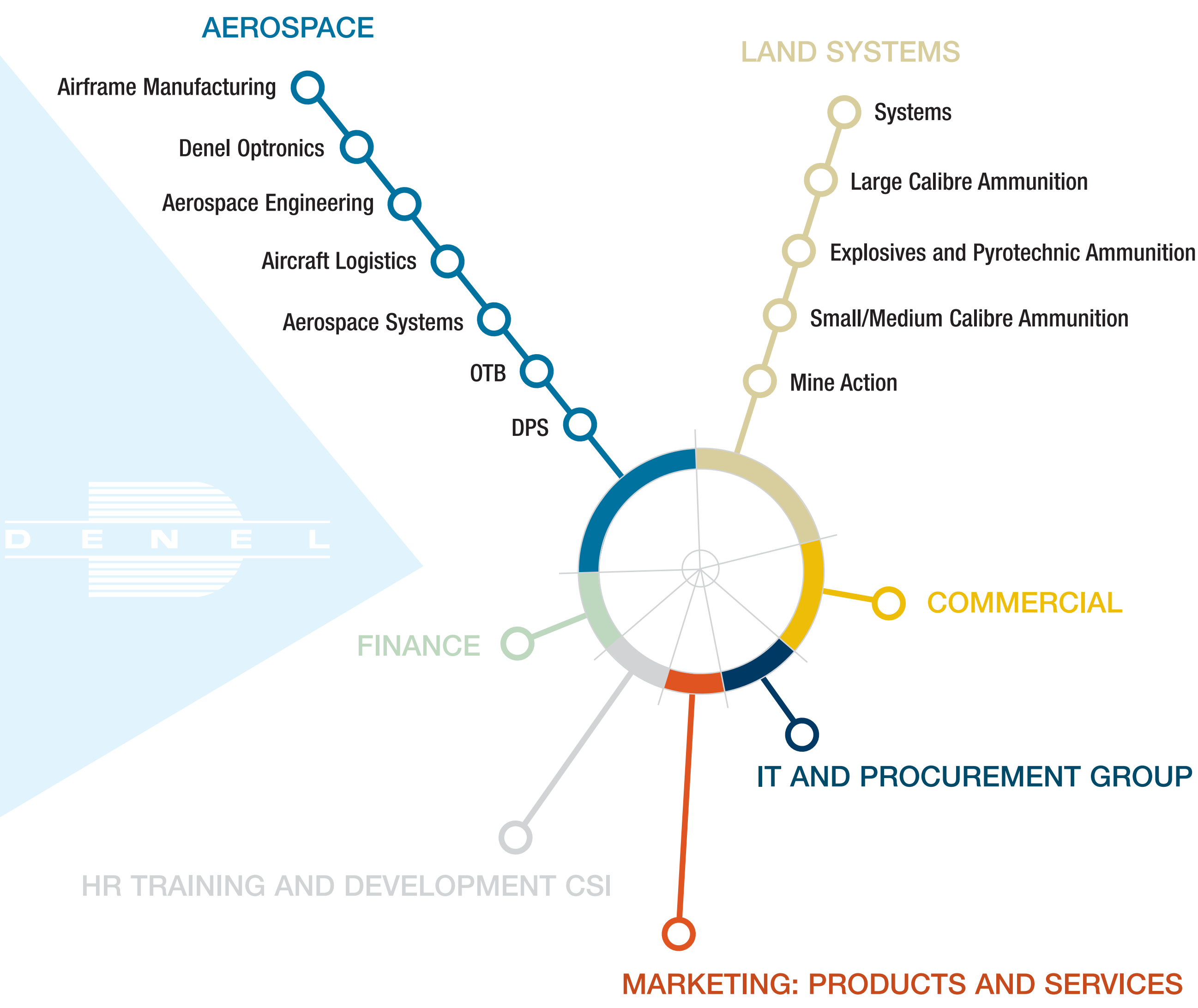


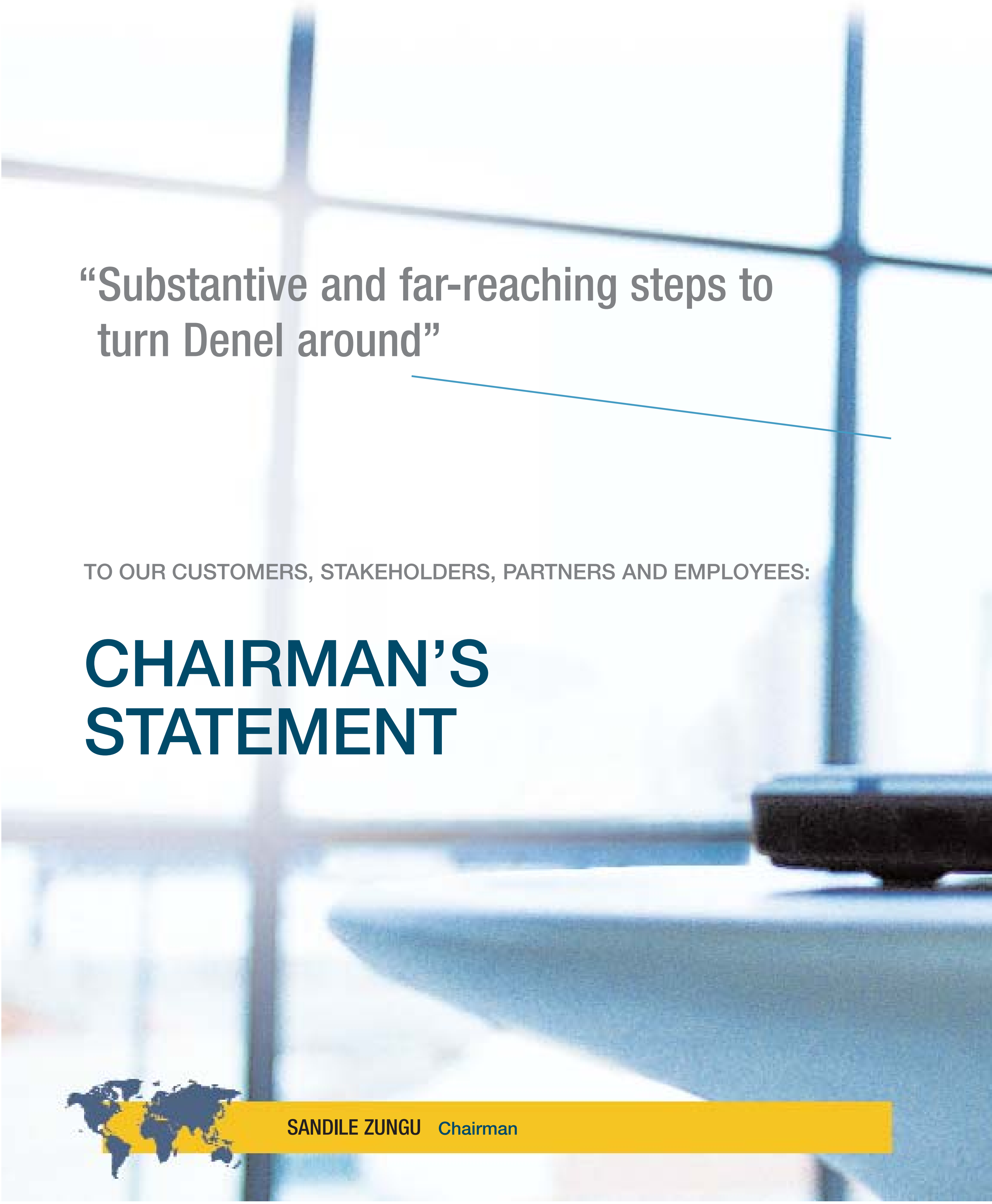
GROSS REVENUE AND GROSS PROFIT (%)



FINANCIAL HIGHLIGHTS

Item	**2004 R millions**	2003 R millions
Gross revenue	**4 442,2**	4 372,4
Loss before taxation	**(357,6)**	(43,6)
Gross profit	**1 287,3**	1 276,3
Net loss	**(377,5)**	(72,6)
Cash outflow before financing activities	**(200,8)**	(229,0)
Share and reserves	**834,5**	1 368,3
Non-current borrowings	**832,1**	840,9
Total assets	**4 091,9**	4 254,0





“Substantive and far-reaching steps to turn Denel around”

TO OUR CUSTOMERS, STAKEHOLDERS, PARTNERS AND EMPLOYEES:

CHAIRMAN’S STATEMENT

SANDILE ZUNGU Chairman


DENEL

INTRODUCTION

A new drive to transform Denel into a globally competitive defence manufacturer.

Denel operates in a highly dynamic and politically challenging international market, the defence and ammunitions industry. The review period was a particularly challenging one. The local currency (the rand) tenaciously defied all forecasts that it would weaken against the dollar and improve South African export prospects. It remained strong throughout the period, reinforced by a weakening US dollar. Although gross revenue is up marginally to R4,4 billion, this has to be seen in the context of the rand strengthening no less than 26% against the US dollar during the year and the implementation of AC133. Our exports have again increased, now standing at 58% of total revenue from last year's 56%.

Denel itself reached a historical crossroad during the review period. At the highest level in Government, there was a new drive to transform Denel into a globally-competitive, world-class defence manufacturer and a key production anchor for the South African defence industry. The appointment of Mr Victor Moche as the Chief Executive Officer of Denel in May 2003 injected a new vigour and drive in top management to turn Denel around from a loss-making state-owned enterprise to one that contributes to both the security and international status of the country. Globally, arms exports have declined significantly following its peak in 2000. The major powers in the developed world continue to dominate global defence spending, through their largesse in defence budget allocations. These countries have strong and protected domestic defence industries and are less reliant on foreign arms acquisitions. As a result, our international arms exports have been to developing nations, such as Brazil, the Middle East, India and Asia. However, we have reinforced efforts to penetrate markets in Europe and the United States of America in the period under review. During the period under review we have seen a radical rationalisation of Denel's product portfolio. This rationalisation will culminate in the positioning of the new product portfolio to generate growth and reinforce the sustainability of markets and market share.

The current management under the leadership of Mr Victor Moche is expected to reverse Denel's past poor performances. The key focus areas for the year ahead will include:

- eliminating inefficiency and duplication in the Group
- disposing of non-core and loss-making divisions and subsidiaries
- renegotiating or exiting loss-making contracts

G6 155 mm WHEELED ARTILLERY SYSTEM

VEKTOR 40 mm AGL

As a values-driven organisation we are committed to conduct our business transactions with integrity.

- accessing new local and international markets
- making Denel a representative and proudly South African organisation
- creating capacity and developing employee skills for market leadership

Denel's transformation, in many respects, will be aimed at improving the organisation's reputation and image, locally and internationally. To increase revenue, we will focus our marketing efforts on opportunities that will position Denel as a supplier of choice for major systems.

As a values-driven organisation we are committed to conduct our business transactions with integrity. Denel subscribes to the corporate governance guidelines in King II and other international codes and is implementing effective risk management and regulatory compliance processes throughout the organisation.

I wish to thank the Minister of Public Enterprises, Mr Alec Erwin, the Department of Public Enterprises, the parliamentary committees for Public Enterprises and the current Denel Board for their support over the past financial year.

Sandile Zungu
Chairman

3 August 2004

ELOPTRO PERISCOPE SYSTEM

ROOIVALK ATTACK HELICOPTER

EAGLE-EYE TARGET ACQUISITION BINOCULAR

BOARD OF DIRECTORS

MAJOR-GENERAL (RETIRED)
IAN DEETLEFS
Appointed to the Board: October 1995

SANDILE DM ZUNGU
CHAIRMAN
Appointed to the Board and as Chairman: June 2001

VICTOR GM MOCHE
CHIEF EXECUTIVE OFFICER
Appointed to the Board: May 2003

DR DANISA E BALOYI
Appointed to the Board: October 1995

MS ZODWA MANASE
Appointed to the Board: June 1998

DR KHOTSO DK MOKHELE
Appointed to the Board: June 2001

ALAN T MUKOKI
Appointed to the Board: June 1998

DR IAN M PHILLIPS
Appointed to the Board: December 1998

POTTIE POTGIETER
GROUP EXECUTIVE DIRECTOR: COMMERCIAL AND IT BUSINESS AND GROUP EXECUTIVE DIRECTOR: FINANCE (ACTING)
Appointed to the Board: January 1997

DR CHRIS J SAUNDERS
Appointed to the Board: June 1998

EDMUND T MAZWAI
Appointed to the Board: June 2001

DR SIBUSISU P SIBISI
Appointed to the Board: June 1998

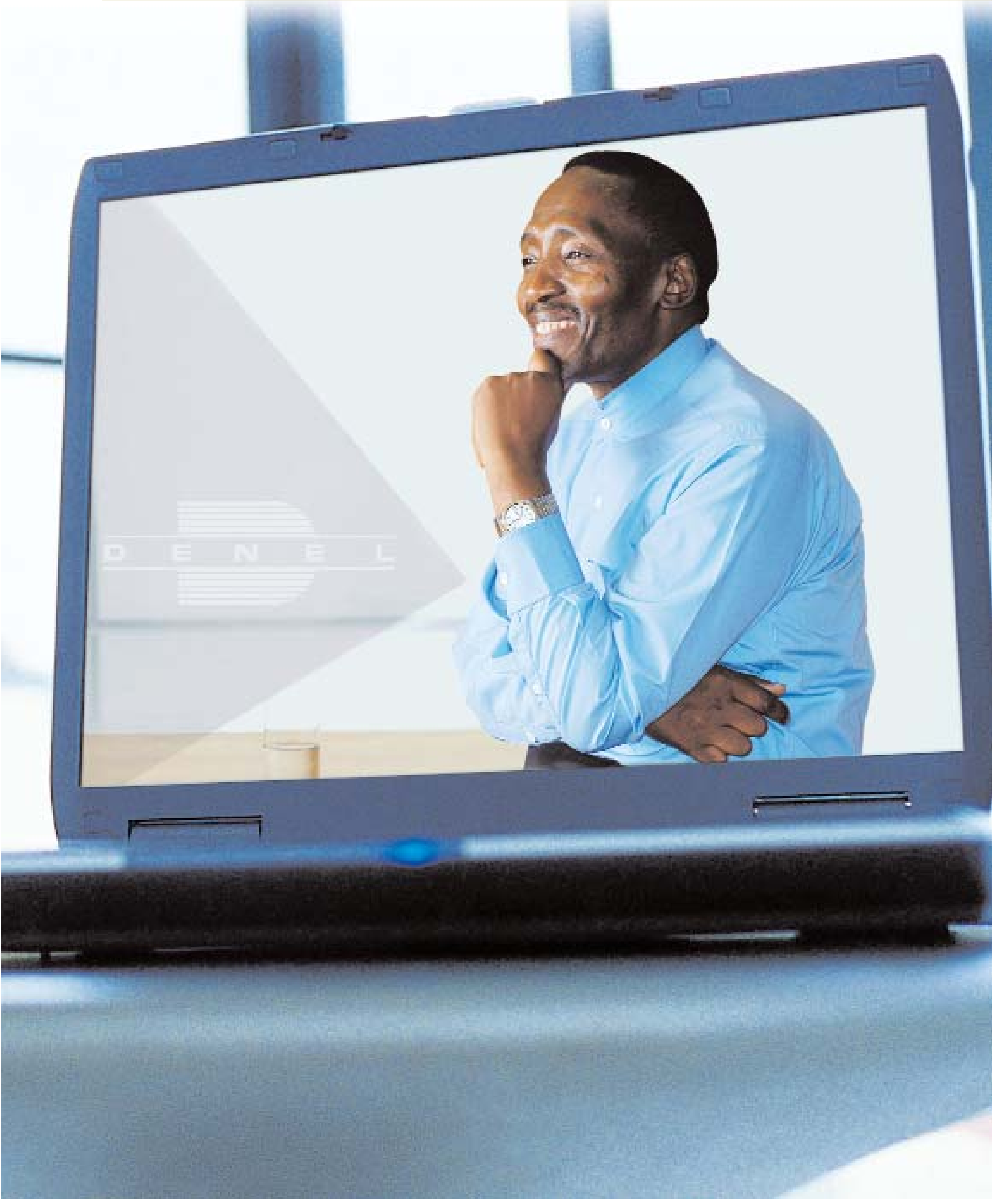
LT-GEN LAMBERT MOLOI
Appointed to the Board: June 1998

> “During the review period, we’ve laid the groundwork for a solid new Denel”

TO OUR CUSTOMERS, STAKEHOLDERS, PARTNERS AND EMPLOYEES:

CEO’s MESSAGE

VICTOR MOCHE Chief Executive Officer


DENEL

Recognition of the critical and important contributions of employees to this business is fundamental to the long-term profitability of Denel.

Denel has experienced a watershed year in which the foundations for a radical turn in the business have been laid and must be consolidated. The period under review gives us the first rays of light on the path back to profitability – further and further away from a history of loss-making and decline. Protection of our revenues as reported in the results as well as their continuous enhancement have served as the lodestar on the road to recovery.

Recognition of the critical and important contributions of employees to this business is fundamental to its long-term profitability of Denel. This reporting period has seen us introduce certain harsh measures to ensure future profitability, to entrench sound corporate governance principles and place Denel on a road to financial sustainability. Our commitment to our people is reflected in a training and development budget that is well above the average for our industry.

In addition, key management interventions introduced in the period included:

- The introduction of an aggressive programme of cost cutting and financial control
- Centralising key support functions
- Creating a common information technology (IT) platform for all operational and support systems and processes
- Rolling out a new performance-based remuneration model
- Improving relations with organised labour
- Comprehensive review of all contracts and agreements

The South African defence budget has declined significantly in the last decade. The South African National Defence Force's R&D budget, as an example, has declined by about 80% in real terms since 1990. Despite the highly competitive global context and limited domestic funding, Denel has managed to grow its current export base to 58% of sales over the last year.

The global defence environment in the period under review has been a buyer's rather than a seller's market. This is due to intense competition and alliance building between the major international players in the industry. This has drastically eroded the profitability of the defence industry of the smaller nations, such as ours. Denel in response has undertaken an aggressive search and construction of global alliances to enhance its access to existing markets as well as developing new channels and new markets.

Customers in these markets expect total systems capability and solutions from suppliers that require massive upfront investment with no guarantee of orders. Companies such as Denel, therefore, find themselves having to survive on small profit margins and lean manufacturing operations. This has a negative result of limited capacity and an inability to meet customer deadlines and expectations.

The objective of this initiative is to develop and implement a strategy for the growth of a sustainable aerospace industry.

Ten years of South Africa's democracy have led to many changes in the country's defence and arms control landscape. South Africa's defence-related policies have anchored and stabilised the process of democratisation. At the end of this era, the time is opportune to review our defence policies to meet the new challenges of the next decade. To this end, Denel strongly supports the intention of the government to review the White Paper on Defence-related Industries and the Defence Review, whose combined effect will be to grow the South African defence industry and facilitate business.

Denel is playing a critical role in the Aerospace Cluster Initiative spearheaded by the Department of Trade and Industry (DTI) and the Council for Scientific and Industrial Research (CSIR). The objective of this initiative is to develop and implement a strategy for the growth of a sustainable aerospace industry. As an original aerospace equipment manufacturer, with existing international collaboration in aerospace design, engineering and manufacturing, Denel is poised to play an anchor role in the realisation of an aerospace cluster in South Africa.

At the close of the year under review, discussions between the Department of Trade and Industry regarding the establishment of an Aerospace Training Academy were well advanced. I am happy to report that Denel is represented on the Ministerial Task team dealing with this issue. The proposed academy augurs well for skills development in the Aerospace industry in South Africa.

We thank the South African Government, our sole shareholder through the Minister of Public Enterprises, for the support Denel has received over the past years. It is this support that encourages us, as the Denel family, to look forward to a bright future.

I wish to express my sincere appreciation to the Denel Board of Directors for the support given to my management team and me during the past financial year.

Victor Moche
Chief Executive Officer

3 August 2004

NATURE OF BUSINESS

The Denel Group is a global player and original equipment manufacturer (OEM) in the aerospace, defence and ammunition sectors. Its core capabilities are in the manufacturing and marketing of systems and products for these sectors, including overhaul, maintenance, repair, refurbishing and upgrading of rotary and fixed-wing aircraft and land systems. The organisation also specialises in landmine clearance and other mine action services, surveillance electronics and commercial products based on plastics.

With the separation of Denel from Armscor in April 1992 the company's operations were diverse and fragmented operating as stand-alone commercial enterprises. The Group consists of 23 divisions and subsidiaries. The majority of these operations have not made any profits over the years with operational costs far exceeding sales revenue. We have embarked on a comprehensive restructuring process to minimise Denel's past annual losses and to ensure its future growth and profitability. Support services, previously duplicated across 23 business units are being centralised and this process will be completed in 2005.

As a growing entity, Denel has found it imperative to establish alliances and partnerships that will enable it to compete effectively in the global market. Denel has successfully established strategic relationships in Africa, Europe, the Middle East, Asia and the United States for co-development projects, technology sharing and access to new technology.

FINANCIAL OVERVIEW

We have met our revenue targets despite a most unfavourable currency situation for a company with a high export-oriented business. Although gross revenue is up marginally to R4,4 billion from last year's R4,3 billion, this has to be seen in the context of the rand strengthening no less than 26% against the US dollar. Revenue from continuing operations increased by 6,7% to R4,4 billion for the year.

The growth measured in South African rand would have been much higher had it not been eroded by the strengthening of the local currency.

To improve Denel's future cash flows, stringent targets have been set for the 2004/2005 financial year. These include aggressive management of operational expenses, optimising the manufacturing operating cycle, reducing inventory to manageable levels, improving the debtors' ledger and the quality of the order book as well as marketing time of our products.

CORPORATE HIGHLIGHTS

HUMAN RESOURCES

Key achievements in the past year include:

- Centralisation of human resources and support functions
- Creating capacity at senior level with the appointment of a Chief of Staff in the Office of the CEO
- The appointment of a group head of procurement and IT as well as other senior management staff
- Centralising and aligning training and development initiatives to address skills need.

The Denel Centre for Learning and Development was launched in March 2004. The centre houses four schools:

- The School of Business Leadership, Marketing and Management to address management development needs in Denel

- The School of Aerospace provides training in aircraft type, product support, electronics, weaponry and apprenticeships for artisans
- The School of Land Systems comprises: explosives training and land systems-specific programmes
- The Denel Youth Foundation Training Programmes replace the Kentron/Denel Bridging School. Sixty selected post-matric learners (from Gauteng) will participate in a one-year pre-tertiary programme. An additional 70 students will be selected from previously disadvantaged schools in rural areas from all provinces to participate in this programme.

Given the enormity of the change under way in Denel, an employee assistance programme was introduced in December 2003, which offers confidential counselling on a range of issues. The focus of the programme is the creation of a healthy working environment. The programme covers current employees and their dependents as well as recently retrenched employees – for up to nine months after retrenchment.

Denel has started to roll out a single performance management system to drive common financial, operational and transformation targets throughout the Group. The objective is to achieve a new performance culture in all business units, innovation and cross-functional teamwork. The performance management system is based on Group profitability, divisional profitability and individual performance.

The decision to establish one centralised and standardised Human Resources Information and payroll system was made. Its implementation and rollout along with the QMuzik ERP system is set for the new financial year.

Denel is represented at two industry bargaining councils and utilises its internal Restructuring and Transformation Coordinating committees for constructive engagement with its employee representatives.

PROCUREMENT AND INFORMATION TECHNOLOGY

Good progress was made in implementing a single enterprise resource planning system that will see around 20 IT systems integrated into one by the end of the new financial year. Capital expenditure of around R70 million has been approved for this project, which will reduce IT costs significantly over time and provide more accurate management information.

Service level agreements were concluded with operating units during the year and inter-group sales policies finalised. The procurement unit has also focused on optimising stock levels to unlock working capital and introduce supply chain management processes. A formal project management office has been established.

In the second half of the year under review, a procurement unit was established to develop a shared services model for Denel. Responsibility for information technology (IT) now vests with this department.

Key achievements of the past year include:

- A single travel management company for the group was appointed, resulting in significant savings
- Fleet management and rationalisation of fleet size
- Procurement of non-production materials and services was consolidated under one shared services model
- Spending with empowerment suppliers increased from R241 million in 2002/3 to R280 million in 2003/4

The new centralised group marketing strategy will maximise the return on marketing and sales investment.

MARKETING

Denel's primary markets are in South Africa, the Middle East, Europe and the Asia Pacific region, while the contribution to sales from the African continent, North and South America is growing.

During the year, market research and strategic marketing functions were established to improve management of market intelligence and introduce a group-wide programme of risk management. The new centralised group marketing strategy will maximise the return on marketing and sales investment and unlock new growth markets for Denel.

Key achievements in the past financial year are as follows:

- Consolidation of marketing responsibilities at the corporate head office while retaining specialist skills at manufacturing plant or business unit level
- Increased efficiencies and greater responsiveness to market trends underpinned by a reduction in cost of sales
- Cementing relations with Brazil and India as part of South Africa's foreign policy initiatives
- Concluding partnership with General Dynamics Land Systems, resulting in building and demonstrating a new light artillery turret system for the US market in a record time of eight months
- Denel received several international awards for its exhibition stands.

Against the background of increasing competition and more discerning customers, Denel's marketers deal in complex selling environments – working with representatives, third-party vendors, governments and procurement directors. Accordingly, functional sales teams are structured to best meet the needs of each project.

A strong pipeline of projects spans the short, medium and long term, while marketing alliances have been created to reduce cost and to increase access to new clients and territories.

REPORT OF THE GROUP EXECUTIVE DIRECTOR: FINANCE

A fully-centralised finance function has been implemented in line with the group strategy on centralisation of support functions.

A major focus for the financial executives during the latter part of 2003/04 was to drive cost-saving programmes and to manage group cash flow more effectively. This will continue to be a major focus in the new financial year, with specific focus on optimising the operating cycle of the group.

The following matters need to be highlighted specifically:

FUNDING REQUIREMENTS

Other than using short-term facilities from commercial banks to accommodate additional requirements, no new borrowing programmes were implemented.

Preparations to issue commercial paper of R500 million were, however, finalised during the latter part of the financial year. The preparations included credit rating for Denel, which was done by Fitch Ratings. A short-term rating of F1+ was awarded to Denel, while the long-term rating was confirmed as AA. Of the R500 million, a commercial paper issue of R250 million took place after balance sheet date.

HEDGING FOREIGN CURRENCY RISK

Due to the focus on the global market the group has significant exposure to foreign currency fluctuations.

The group follows the approach of hedging exposure on contracts which are foreign currency-denominated as soon as the contracts are concluded. This is done through either forward exchange contracts or foreign currency options.

STRATEGIC GLOBAL PARTNERSHIPS

Defence manufacturing is characterised by technological sophistication as well as political and economic alliances. As a small player by international standards, Denel has found it imperative to establish alliances and partnerships that will enable it to fully compete in the global markets. Denel has successfully established strategic relationships in Africa, Europe, Middle East, Asia and the United States for co-development projects, technology sharing and access to new technology.

Denel has successfully established strategic relationships in Africa, Europe, Middle East, Asia and the United States.

EXECUTIVE COMMITTEE

KNOX MSEBENZI
GROUP EXECUTIVE DIRECTOR: AEROSPACE

TONY SIMON
GROUP EXECUTIVE DIRECTOR: LAND SYSTEMS (ACTING)

VICTOR GM MOCHE
CHIEF EXECUTIVE OFFICER

POTTIE POTGIETER
GROUP EXECUTIVE DIRECTOR: COMMERCIAL AND IT BUSINESS AND GROUP EXECUTIVE DIRECTOR: FINANCE (ACTING)

TOMMY VAN REENEN
COMPANY SECRETARY

ZWELAKHE NTSHEPE
GROUP DIRECTOR – MARKETING

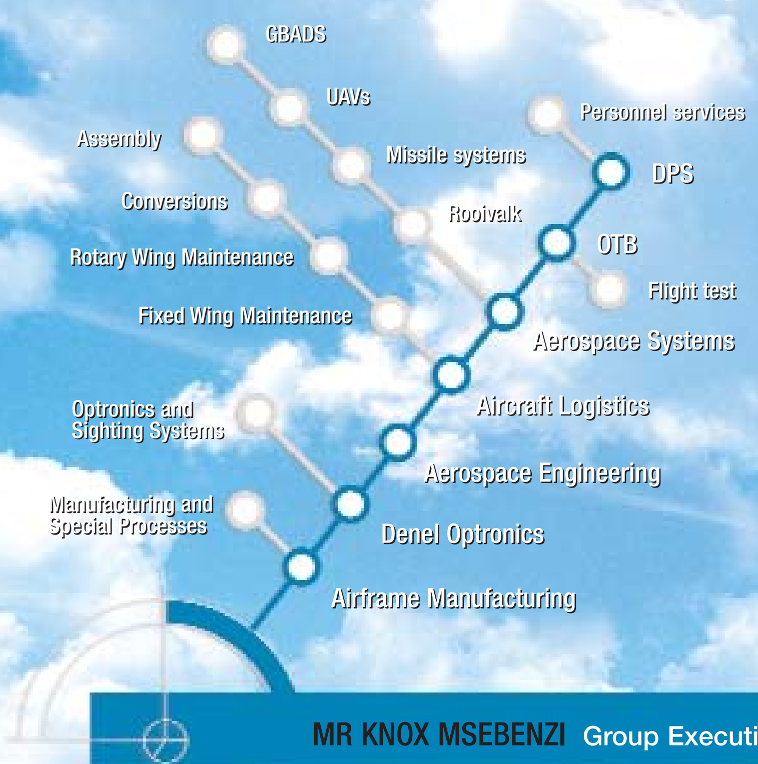
EUGENE MARTIN
GROUP DIRECTOR – HUMAN RESOURCES

TANYA SWIEGELAAR
CHIEF LEGAL COUNSEL

CASSANDRA GABRIEL
CHIEF OF STAFF – OFFICE OF THE CEO

JAMES SEKHASIMBE
GROUP DIRECTOR – PROCUREMENT AND IT

AEROSPACE



MR KNOX MSEBENZI Group Executive Director Denel Aerospace Group

HIGHLIGHTS OF THE PAST YEAR

- Contracted by BAE Systems/Saab for design, development and supply of helmet tracking system for Eurofighter-Typhoon and export version of Gripen
- OTB involvement with NASA's Mars rover mission
- Installation of manufacturing cell and start of production of Boeing commercial airplanes detail components for The Boeing Company
- Further exports of Ingwe anti-armour missile
- An international award for best live demonstration at IDEX 2003 exhibition in Abu Dhabi, UAE

GRIPEN FIGHTER AIRCRAFT

ELOPTRO LH40 LASER RANGEFINDER

This group has been restructured, with effect from 1 April 2004, into the following units:

- **Airframe Manufacturing** – general manufacturing processes and high-volume, low-margin component manufacture for Denel and third parties, aerostructure sub-assemblies, as well as assembly and integration of airframes. The facility has comprehensive machine shops, a fabrication plant, assembly line and composite materials department.

- **Denel Optronics** – the creation of a world-class optronics business through the merger of Eloptro, Cumulus and the Kenis imaging infrared camera unit, for design and manufacture of optical and laser products, eg laser range-finders, target acquisition systems and submarine periscopes; electro-optical stabilised observation and surveillance systems, and helmet-mounted sighting and tracking systems.

- **Aerospace Engineering** – structural and system design, testing, subsystem design and integration, aerodynamic design and analysis, weapons and stores integration and clearance; avionics system engineering and software development; electrical system design and analysis; mission planning and debriefing systems; test and integration, including ground testing and full flight testing.

- **Aircraft Logistics** – integrated system support and product support for fixed and rotary wing transport and tactical aircraft; maintenance, conversions and assembly, component repair, laboratory/calibration services, aircraft painting and aircraft refurbishment/modernisation.

- **Aerospace Systems** – systems development for Rooivalk combat helicopter, missile and guided weapons systems, unmanned aerial vehicles (UAVs) and ground-based air defence systems (GBADS).

- **OTB** – a versatile, multipurpose missile and aircraft test range.

- **Denel Personnel Solutions** – labour broking and human capital-related management services.

Denel Aviation is split into two operating divisions, namely **Airframe Manufacturing** and **Aircraft Logistics**. The rationale is to separate the high-volume, low-margin

SEEKER UAV

INGWE ANTI-ARMOUR MISSILE

manufacturing work from the high-variety, low-volume (and normally high-margin) work. This split will be implemented once the clean-up operation of existing loss-making contracts has been completed and the requisite critical volume of work has been achieved. The clean-up operation is expected to have a knock-on effect by making operations more competitive, thus rates quoted to potential clients will be attractive. This should attract higher volumes of work, making operations even more competitive due to economies of scale.

The formation of **Denel Optronics** has resulted in a skilled and experienced workforce with diverse expertise in international markets, supported by more appropriate facilities, plant and infrastructure. Denel Optronics' competitive core product lines and technology are reinforced by a strong intellectual property base vested in its own designs and enjoy the support of a mature international customer base.

The **OTB test range** has successfully capitalised on its strategic advantages to generate additional volumes of external business.

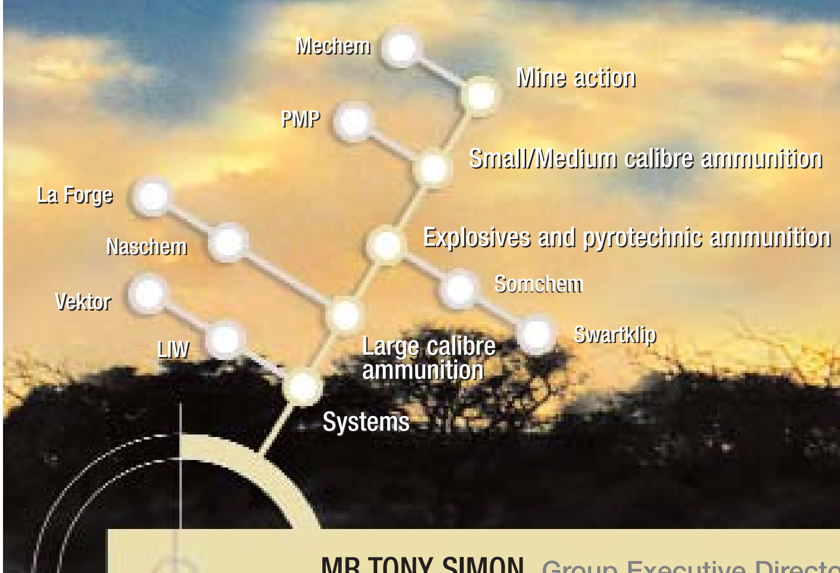
Denel Personnel Solutions has extended its services beyond pure labour brokerage to specialise in related human capital solutions, including payroll bureau services, staff loan schemes, executive search and placements, national keypoint security services, outsourced human resource management, financial administration and management accounting services.

The current model where each division has an engineering department to service it is not optimal. The creation of an **Aerospace Engineering Division** will be constituted as a viable business unit providing strategic and commercial services to the aerospace group. Ultimately, there should be one Denel engineering division servicing the whole company. The consolidation of engineering functions with this strategic vision is currently taking place in the divisions.

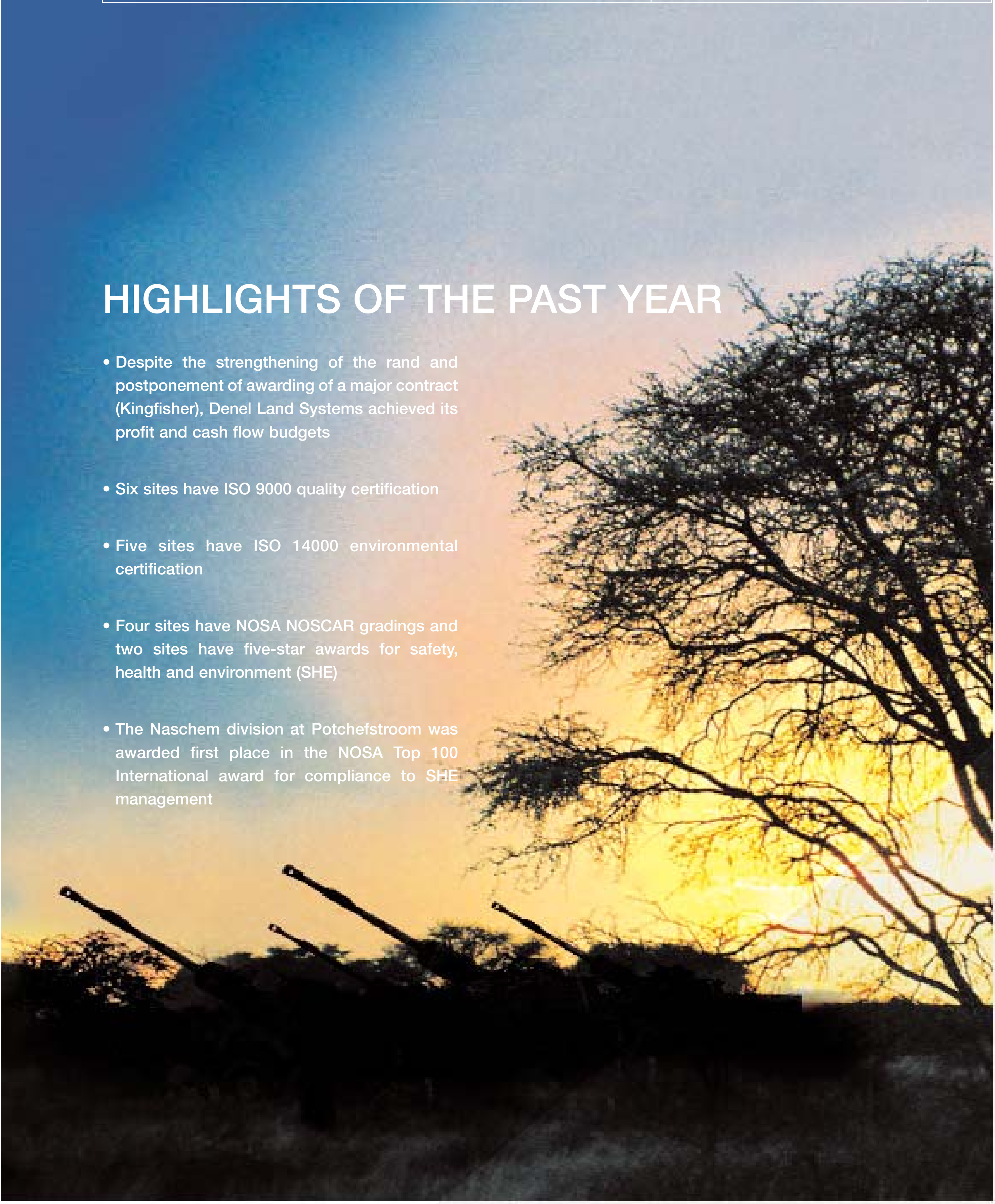
POSITIONING

Driven by the performance objectives of speed, price, quality, flexibility and reliability, Denel Aerospace is intent on improving its competitiveness in the international marketplace.

LAND SYSTEMS



MR TONY SIMON Group Executive Director Denel Land Systems Group



HIGHLIGHTS OF THE PAST YEAR

- Despite the strengthening of the rand and postponement of awarding of a major contract (Kingfisher), Denel Land Systems achieved its profit and cash flow budgets

- Six sites have ISO 9000 quality certification

- Five sites have ISO 14000 environmental certification

- Four sites have NOSA NOSCAR gradings and two sites have five-star awards for safety, health and environment (SHE)

- The Naschem division at Potchefstroom was awarded first place in the NOSA Top 100 International award for compliance to SHE management

MR TONY SIMON Group Executive Director Denel Land Systems Group

STRUCTURES

POSITIONING

The group has been restructured into five focused units, with effect from 1 April 2004, with merger of processes at various stages of implementation:

- **Systems** – this unit comprises the merged operations of LIW and Vektor. Its core competencies include the design, development, assembly and support of weapon systems and a spectrum of turrets for diverse military applications.

- **Large Calibre Ammunition** – the amalgamated operations of Naschem and La Forge include the design, development, manufacture and supply of large calibre ammunition products, military detonators and explosives plants.

- **Explosives and Pyrotechnic Ammunition** – the combined businesses of Somchem and Swartklip, specialising in solid fuel propulsion products, energetic material applications, pyrotechnic and high-explosive products for military, law enforcement and commercial use.

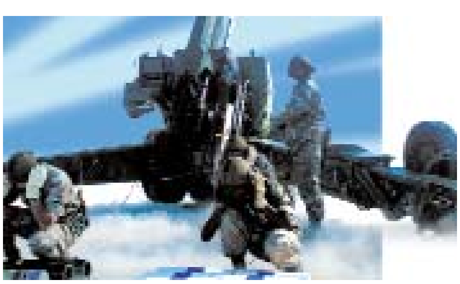
- **Small/medium Calibre Ammunition** – formerly called PMP, this plant is one of the largest small arms ammunition manufacturers in the world and an internationally-established manufacturer of military and sporting ammunition products and components.

- **Mine Action** – Mechem is an acknowledged world leader in cost-effective humanitarian mine action services, including landmine removal, mine awareness training, victim assistance and mine stockpile destruction.

MINE CLEARING SYSTEM

PROSPECTS

Denel Land Systems will focus on increasing sales in existing markets and penetrating new markets by supplying quality, cost-effective consumables and integrated systems, and introducing niche products into the market. This will be driven by an intensified focus on developing selected, market-driven technologies and retaining and developing considerable intellectual capital in the group.



G5 155 mm ARTILLERY SYSTEM

ROOIKAT WITH A LIW TURRET

TRUCK-MOUNTED 155 mm ARTILLERY SYSTEM

COMMERCIAL AND IT BUSINESS

MR POTTIE POTGIETER Group Executive Director Denel Commercial Group

HIGHLIGHTS OF THE PAST YEAR

- Good business performance by the properties group
- Solid financial performance by Dendustri
- A centralised property management model for Denel's industrial properties has been implemented
- Rigorous risk management processes have resulted in low claims ratio and good business performance for Densecure (Pty) Limited

STRUCTURE

As part of the group strategy to focus on core business and competencies, decisions have been made by the Board to exit some of the commercial businesses. These instances have been highlighted in the profile of each business.

DENDUSTRI

This unit provides engineering services and specific products to industry, including manufacturing and maintenance of anodes for the aluminium industry.

PROPERTIES GROUP

Bonaero Park (Pty) Limited – management of commercial property portfolio involved in the retail, office and industrial property sectors.

Denel Properties (Pty) Limited – speculative property development in the residential, office and commercial sectors.

Aero Properties (Pty) Limited – holding company of valuable vacant and developed land adjacent to Johannesburg International Airport.

ALUMINIUM COMPONENTS
MANUFACTURED BY DENDUSTRI

IT SHAREHOLDINGS

- 47,4% shareholding in Cosource (Pty) Limited (owner of Qmuzik software)
- 23% shareholding in Ariviakom (Pty) Limited*
- 51% shareholding in Sybase (SA) (Pty) Limited*

OTHER BUSINESS

Densecure (Pty) Limited – the captive insurance company of the Denel Group.

Irenco (Pty) Limited* – this is the third-party manufacturer of electronic and plastic injection-moulding products as well as manufacturer of own product range of security products, dynamic weigh-in-motion systems, onboard computers and a vehicle monitor system.

Specialised Protein Products (Pty) Limited (SPP)* – this unit specialises in the production of soy-based, human-grade protein-rich foodstuffs.

** Decisions to exit have been made by the Board.*

STRATEGIC RELATIONSHIPS IN: AFRICA, EUROPE, MIDDLE EAST, FAR EAST, USA

STATEMENT ON CORPORATE GOVERNANCE

The Group endorses the code of corporate practices and conduct as contained in the King II Report and affirms its commitment to comply in all material respects with the principles incorporated in this report. Denel and its subsidiaries are intent on implementing the highest standards of corporate governance. The Group is committed to good corporate citizenship and organisational integrity in the running of its affairs.

This commitment provides stakeholders with the comfort that the Group's affairs are being managed in an ethical and disciplined manner. Denel's philosophy is founded on principles of transparency, accountability and responsibility.

Compliance with the Public Finance Management Act of 1999 is an integral part of the objectives of the Company as approved by the Board of Directors.

THE BOARD OF DIRECTORS AND BOARD COMMITTEES

The Minister of Public Enterprises appoints the Board of Directors on behalf of the shareholder, the Government of South Africa.

The directors maintain full and effective control over the affairs of the Company. In terms of the governance philosophy of the Company there is a separation of responsibility for running the Board and the executive responsibility for running the business. The Board has delegated the authority to run the day-to-day affairs of the Company to the Chief Executive Officer and the executive directors. The roles of Chairman and Chief Executive Officer are separated and no individual has unfettered powers of decision. The Board commits to appraise the performance of both the Chairman and the Chief Executive Officer at least once a year.

In addition to the powers conferred on it by the Articles of Association, the Board has reserved the right to the following matters:

- Purpose and values of the Group
- Strategic objectives of the Group
- Identification of key risks and performance areas
- Appointment of the Chief Executive Officer and development of a succession plan
- Determination of levels of materiality
- Monitoring of the implementation by management of Board plans and strategies.

The international armaments environment is characterised by a growing sophistication of technology, international political alignments, global industrial consolidations and aggressive and competitive marketing.

The Board comprises two executive and eleven non-executive directors with collective responsibility for determining major policies and strategies. The executive directors are mainly responsible for creating and maintaining Group policy on operational issues. The decision-making powers of the non-executive directors carry equal weight to those of the executive directors in the Board's deliberations and resolutions. The non-executive directors remain independent of management and are free to exercise their independent judgement. Their business expertise enables them to prudently evaluate strategy and ensure decisions that are taken are at the Group's best interests.

The Board meets at least once a quarter to execute its mandate, but special meetings of the Board are convened as and when the need arises.

The Chairman meets routinely with the non-executive directors to discuss his performance and other issues.

When it is necessary, a non-executive director is permitted to obtain independent professional advice in order to ensure that management acted in the best interests of the Company. All directors have unhindered access to the Chairman, Chief Executive Director, Financial Director and Company Secretary as well as unrestricted access to all company information, records and property.

The Company Secretary is responsible to ensure both the effective functioning of the Board and the proper administration of the Board proceedings.

EXECUTIVE COMMITTEE

The Board delegates the day-to-day management of the Group to the Chief Executive Officer assisted by the Executive Committee. The Executive Committee facilitates the effective management of all Group operational activities, acting as a medium of communication and coordination between all the various business units, Group companies and the Board. The Executive Committee is also responsible for the Group policies and strategies and for monitoring their implementation according to the Board's directives.

Twenty-five meetings of the Executive Committee are scheduled for the forthcoming year.

Members of the Executive Committee comprise:

VGM Moche	Chief Executive Officer and Chairman
CC Gabriel	Chief of Staff: Office of the CEO
E Martin	Group Director: Human Resources
MZ Msebenzi	Group Executive Director: Aerospace
ZN Ntshepe	Group Director: Marketing
HD du P Potgieter	Group Executive Director: Commercial and IT Business Group Executive Director: Finance (Acting)
JM Sekhasimbe	Group Director: Procurement and IT
AF Simon	Group Executive Director: Land Systems (Acting)
T Swiegelaar	Chief Legal Counsel
Dr TJ van Reenen	Company Secretary

BOARD COMMITTEES

Specific responsibilities have been delegated to Board committees with defined terms of reference. The Board committees are as follows:

AUDIT COMMITTEE

The Audit Committee consists of executive and non-executive directors of which the chairperson is a non-executive director.

The Audit Committee has adopted formal written terms of reference dealing with membership, structure and levels of authority and duties that have been approved by the Board.

The Audit Committee was established in 1992 to assist the Board in discharging its responsibilities to safeguard the Group's assets, maintaining adequate accounting records and developing and maintaining effective systems of internal control. It also oversees the financial reporting process and is concerned with compliance with accounting policies, Group policies, legal requirements and internal controls within the Group. It interacts with and evaluates the effectiveness of the external and internal audit processes and reviews compliance with the Group code of ethics.

The Audit Committee meets at least two times per year, and reviews the adequacy and continuous improvement of the internal control systems. The external and internal auditors attend these meetings. The scope of the audit and internal controls are discussed between the Audit Committee and the external auditors as part of the process of each audit. The external and internal auditors have unrestricted access to the Audit Committee and its chairperson.

The Audit Committee has set a principle that the external auditors would not perform non-audit services, whenever possible. The amount paid for non-audit services to the external auditors is R0,4 million and relates to work performed to conclude tax related matters and issue submission of an audit certificate for the Commercial Paper Programme.

There are Audit committees for divisions and subsidiary companies. These committees have a mandate from the Board Audit Committee and report to this committee on a regular basis.

The Audit Committee has evaluated the Group and the Company annual financial statements for the year ended 31 March 2004 and concluded that they comply in all material respects with the requirements of the South African Companies Act, the PFMA and South African GAAP.

The Board is satisfied that the Audit Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

PERSONNEL AND REMUNERATION COMMITTEE

The Personnel and Remuneration Committee is constituted as a subcommittee of the Board and operates within the terms of reference set by the Board. The responsibilities of the committee are, inter alia, to determine Group human resources policies and strategies, the remuneration strategies and the remuneration as well as incentives for those executives reporting directly to the Chief Executive Officer.

Directors' emoluments have been disclosed in the Directors' Report in terms of the PFMA Act.

The Board is satisfied that the Personnel and Remuneration Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

CHAIRMAN'S COMMITTEE

The Chairman's Committee meets on a regular basis as a subcommittee of the Board to be informed of important matters deliberated at the Executive Committee meetings and to attend to matters of urgency arising out of the day-to-day business.

The Board is satisfied that the Chairman's Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

TREASURY COMMITTEE

The Treasury Committee was established in 1992 to act in an advisory role with regard to the investment strategy of Denel with the objective to optimise the yield on the investment portfolio and to minimise risks. The committee also evaluates risks the Group is exposed to relating to guarantees, foreign exchange exposure and cover, and advises the Board on the financing requirements.

The Board also appoints independent specialists, such as investment analysts, to provide an objective and expert opinion with regard to both the current and expected economic environment in which Denel operates. These specialists, are not members of the Board, do not form part of the quorum, attend meetings on invitation and do not have a vote on decisions that are made by the committee.

The Board is satisfied that the Treasury Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

EMPOWERMENT AND TRANSFORMATION COMMITTEE

The committee has the responsibility to review and monitor the following policies and plans:

- Affirmative procurement policy
- Corporate social investment policy
- Employment equity policy
- Potential development policy
- Succession planning model
- Education, training and development
- Small, medium and micro enterprises development/emerging black business

and provides strategic leadership on empowerment and transformation.

The Board is satisfied that the Empowerment and Transformation Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

RISK AND STRATEGY COMMITTEE

The committee is constituted as a subcommittee to assist the Board of Directors to give strategic direction to the Company, to monitor management in implementing Board plans and strategies and to review significant risk management issues, and other significant risks facing the Company.

An ongoing process of identifying, evaluating and managing the significant risks faced by the Company has been in place during the year under review and up to the date of approval of the annual report and financial statements.

There is a documented and tested process in place that allows the Company to continue its critical business processes in the event of a disastrous incident impacting on its activities.

The Board is satisfied that the Risk and Strategy Committee has carried out its responsibilities for the year under review in compliance with its terms of reference.

FINANCIAL STATEMENTS

The Group subscribes to a policy of providing meaningful, transparent, timely and accurate communication to its primary stakeholders.

The directors are responsible for the preparation and final approval of the annual financial statements. The external auditors are responsible for the auditing of the annual financial statements and expressing an opinion thereon following the execution of their statutory duties.

Suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates are applied in the preparation of the annual financial statements, which fairly present the state of affairs of the Group. The financial statements are prepared in accordance with South African Generally Accepted Accounting Practices, and in compliance with the South African Companies Act. Adequate accounting records are kept.

The going-concern basis has been adopted in preparing the annual financial statements. The directors are confident that the Group will continue to be a going concern in the foreseeable future.

INTERNAL CONTROLS

The Board is responsible for the Group's systems of internal financial and operational controls. These controls are designed to provide reasonable, but not absolute, assurance regarding the integrity and reliability of the annual financial statements, that assets are adequately safeguarded against material loss and that transactions are properly authorised and recorded.

The controls are based on established written policies and procedures, which are monitored throughout the Group and are implemented by trained and skilled personnel. There is segregation of duties through clearly defined lines of accountability and delegation of authority.

The control systems make provision for comprehensive reporting and analyses of actual results against approved standards and budgets. All employees are required to maintain the highest ethical standards in ensuring that the Group's business practices are conducted in a manner which in all respects is beyond reproach.

During the year under review, the directors have no reason to believe that any material breakdown in the functioning of these controls, procedures and systems has occurred. A material breakdown is defined as a weakness in process or financial systems, which would result in a material loss requiring disclosure in the annual financial statements.

The Board sets the policy on internal control that is implemented by management.

This is achieved through written policies and procedures that have a clearly defined operating structure with lines of responsibility and delegated authority. The Executive Committee chaired by the Chief Executive Officer manages this on a day-to-day basis. The policies and procedures are reviewed on a regular basis and updated where necessary.

The Board separately reviews the most significant risks facing the Group, their potential impact and likelihood of occurrence and the control strategies in place to mitigate them.

INTERNAL AUDIT

The Directors' Report contains a statement relating to the directors' responsibilities. To enable the directors to fulfil these responsibilities and maintain systems of internal control, which reduces the risk of error or loss, the internal audit function independently appraises the Group's systems of internal control.

The Group's internal audit department has a mandate from the Audit Committee to function as an independent and objective assurance and consulting body that appraises the adequacy and effectiveness of the Group's systems, internal controls and accounting records. It also assists Denel to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of the risk management, control and governance processes.

The Chief Internal Auditor, as head of the department, reports administratively to the Chief Executive Officer and has direct access to the chairperson of the Audit Committee and the chairperson of the Board. Internal audit provides the audit findings to management and attends the Audit Committee meetings.

Internal audit provides the following to reduce or mitigate the risks in Denel:

- Assurance that the processes are adequate to identify, manage and monitor the significant Group risks. This includes the means of safeguarding assets, the efficient management of the Group's resources and the effective conduct of its operations.
- Confirm the appropriateness, adequacy and effective operation of the established internal control systems.
- Governance – internal audit assists the directors and management to achieve the goals of Denel by evaluating and recommending improvements to the process through which goals and values are established and communicated.

The internal audit plan is based on the risk assessment for the Denel Group, issues highlighted by the Audit Committee and management as well as issues identified through the fraud hotlines. The internal audit department coordinates the audit activities with the external auditors and other providers of assurance services in order to obtain optimal coverage of risks and controls and to minimise duplication of effort.

The Audit Committee approves the audit plan, which is determined annually.

FORENSIC AUDIT

During the year the forensic audit department was formed to investigate and report on irregularities, fraud and corruption. This was done to enable the internal audit department to focus on the normal routine audits.

The Chief Forensic Auditor reports directly to the Chief Executive Officer and has direct access to the chairpersons of the Audit Committee and the Board.

RISK MANAGEMENT

The Group recognises that managing risk represents an integral part of generating sustainable shareholder value and enhancing stakeholder interest.

Denel manages risks in all its business operations on a continuous basis. The ability of Denel to effectively manage its risks is essential in order to meet its vision and objectives of continuous integrity and self-improvement in terms of financial performance, increased market share, human resource development, social investment and technological abilities. Effective risk management is also central to the Group's need for safe and secure operations, consistent with the responsibility to stakeholders and clients alike. Protection of Denel's integrity, reputation and continuous operations are of the utmost importance.

Key steps in the management process are the systematic and continuous identification of potential loss exposures in terms of severity and frequency probabilities and risk reward opportunities. The application of sound risk response procedures and the financing of such risk response procedures, consistent with Denel's financial resources, are essential elements to ensure the success of the process.

The risk management process is based on a continuous assessment of Denel's exposure to a wide spectrum of risks. Denel identifies, analyses, monitors and controls all major classes of risks. These include credit risk (the potential loss of asset value due to a change in the ability of a debtor to perform as agreed), and market risk (the potential loss in value due to unfavourable changes in market prices and value of financial contracts). It also addresses operational risks, which include the risk of business process disruption caused by failure or losses involving the performance of people, relationships, systems, physical assets, or losses from external sources, technology risk and compliance risk.

Management is primarily responsible for the continuous identification, assessment and response to the risks. The Board of Directors has the ultimate responsibility to ensure that a prudent risk management programme has been implemented.

WORKER PARTICIPATION AND EMPOWERMENT

Denel believes that economically viable and self-sustaining employment equity is an essential part of corporate governance. The Group promotes empowerment of its employees through participative structures on employee-related matters, training, development and information sharing.

The Employment Equity and Skills Development Acts have provided a useful framework for formalising Denel's approach, and the Group's employment policies are designed to provide equal opportunities, without discrimination, to all employees.

The Group complies with the objectives and requirements of the legislation.

CODE OF ETHICS

Denel's code of ethics requires all employees within the Group to act with the utmost good faith and integrity in all transactions and with all stakeholders with whom they interact. It commits the Company and its employees to sound business practices and compliance with legislation.

A sound procurement and provisioning policy has been developed for the Group to ensure efficient, transparent, competitive and cost-effective resourcing of requirements. The Procurement Committee at corporate as well as those at divisional level ensures adherence to the policy and also that the objective to involve SMMEs and other empowerment structures in the supply chain of goods and services to the Group are achieved.

COMMUNICATION

The Group acknowledges that it operates within a community and values a good working relationship with its stakeholders. Denel consistently strives to strengthen links through regular communication with its stakeholders, which conforms to the criterion of timeous, objective, relevant and understandable communication, focused on substance and not form, of both financial and non-financial matters.

DETAILS OF THE ATTENDANCE OF MEETINGS – 2004

		Board meetings (#6)	Chairperson's Committee (#3)		Board Audit+ Committee (#2)	
Board of Directors	Composition	Attendance	Composition	Attendance	Composition	Attendance
Mr SDM Zungu	Chairperson	6	Chairperson	3		
Mr VGM Moche ***†	Member	5	Member	2	Member	2
Mr MV Sisulu *†	Member	1	Member	0	Member	0
Dr DE Baloyi	Member	4	Member	2	Member	1
Mr I Deetlefs	Member	5			Member	2
Mr MC Jita **†	Member	5	Member	2	Member	1
Ms ZP Manase	Member	1	Member	1	Chairperson	1
Mr ET Mazwai	Member	4				
Dr KDK Mokhele	Member	6				
Lt Gen L Moloi	Member	6				
Mr AT Mukoki	Member	2	Member	1	Member	2
Dr IM Phillips	Member	4			Member	2
Mr HD du P Potgieter †	Member	6	Member	3	Member	2
Dr CJ Saunders	Member	5				
Dr SP Sibisi	Member	5				

 # Number of meetings per annum
† Executive director
** Resigned 31 October 2003*
*** Resigned 31 December 2003*
**** Appointed 1 May 2003*

+ In addition to the Board Audit Committee meetings, separate audit sub-committee meetings for the different business groups, which are also attended by non-executive directors and which report to the Board Audit Committee, are also convened at least twice a year.

DETAILS OF THE ATTENDANCE OF MEETINGS – 2003

	Board/special meetings (11#)	Chairperson's Committee (#5)		Audit Committee (#4)	
Board of Directors	Attendance	Composition	Attendance	Composition	Attendance
SDM Zungu	11	Chairperson	5		
J Botha	9	Member	4	Member	4
MV Sisulu	7	Member	4	Member	2
Dr DE Baloyi	8	Member	5	Member	3
I Deetlefs	10			Member	4
MC Jita	10	Member	3	Member	4
Ms ZP Manase	7	Member	3	Chairperson	4
ET Mazwai	10				
Dr KDK Mokhele	8				
Lt Gen L Moloi	10				
AT Mukoki	8	Member	4	Member	1
Dr IM Phillips	8			Member	3
HD du P Potgieter	10	Member	5	Member	4
Dr CJ Saunders	6				
Dr SP Sibisi	5				

 # Number of meetings per annum
** Executive director*

Personnel and Remuneration Committee (#2)		Empowerment and Transformation Committee (#1)		Board Treasury Committee (#2)		Board Risk and Strategy Committee (#2)	
Composition	Attendance	Composition	Attendance	Composition	Attendance	Composition	Attendance
Chairperson	2	Member	0			Chairperson	2
Member	2	Member	1	Member	2	Member	2
Member	0	Member	0			Member	1
Member	1	Chairperson	1				
Member	2						
Member	2			Member	2	Member	2
Member	1						
		Member	1	Member	2		
				Member	2		
		Member	0	Member	1	Member	1
Member	2			Chairperson	2		
		Member	0			Member	2
						Member	0
						Member	2

Personnel and Remuneration Committee (#3)		Empowerment and Transformation Committee (#3)	
Composition	Attendance	Composition	Attendance
Chairperson	3	Member	0
Member	3	Member	3
Member	2	Member	2
Member	2	Chairperson	3
Member	3		
Member	3		
Member	0		
		Member	3
		Member	2
Member	1		
		Member	1

SHE VISION OF DENEL

Denel acknowledges the benefits to be gained from an integrated system to manage the natural environment and worker health and safety, and has therefore structured its SHE management system to fully exploit the advantages of this interrelationship. The SHE committees play a major role in the responsibility of reporting and solving problems in the workplace.

Denel manages a total of 34 152 hectares of land in a diverse variety of natural habitats, which pose an enormous challenge to management and staff and calls for research and environmental management projects.

Denel is proactively phasing out hazardous substances like asbestos. Other hazardous substances such as lead and chlorinated solvents are under strict control. Employees exposed to these substances are under continuous medical observation.

Emphasis is placed on primary health care. HIV/Aids awareness campaigns were held at several divisions and support groups were established.

Denel is a member of the World Wide Fund for Nature (WWF) South Africa.

SHE POLICY

Denel recognises stakeholders' concern regarding its business activities and addresses these concerns through SHE policies. These policies are proof of the commitment, accountability and transparency towards stakeholders.

The divisions of Denel are responsible for SHE management activities according to the Group SHE policy. Each division ensures that this policy is understood, implemented at all levels and set objectives and targets are relevant to its unique product portfolio.

Denel's environmental policy calls for continuous improvement in environmental management activities such as waste minimisation and pollution prevention. Denel is committed to the integrated management of environment issues as experienced by employees, customers, consumers, distributors and contractors.

All the Denel divisions have the necessary procedures, standards and instructions that support the Denel policy.

ACTIVITIES AND PRODUCTS

Denel's SHE management activities are aimed at meeting all SHE legal requirements and the education of its employees and the community in matters relating to their immediate environment. A concerted effort is being made to preserve nature and historical heritage elements on Denel property.

The Company's range of products and services reflect the benefits of integrating SHE based principles into all aspects of its activities. Denel is a leader in minefield clearance techniques and ensures that a safe natural environment for animals and humans is restored.

Most of the divisions set themselves strict goals to ensure continuous SHE improvement. The divisions in the explosive products industry have a good track record of very few explosives related accidents and achieve more than 500 000 disabling injury-free hours on a regular basis.

SHE MANAGEMENT SYSTEMS

Denel has from its inception been proactively implementing management systems to ensure that these ideals are being met.

NOSA RISK MANAGEMENT SYSTEM

The National Occupational Safety Association's (NOSA's) Integrated SHE Risk Management System (Platinum grading) has been implemented by Somchem, Naschem, LIW and Dendustri.

"The NOSA Integrated Five Star System is a system framework for the management of safety, health and the environment in an integrated manner based on the risk profile of any particular site, with an emphasis on effectiveness at an operational level."

The requirements for star gradings are:

Number of Stars	Grading %	DIFR
NOSCAR	≥ 95%	≤ 0,8
5 Star	≥ 91%	≤ 1
4 Star	≥ 75%	≤ 2
3 Star	≥ 61%	≤ 3

Several facilities once again obtained a NOSCAR grading.

- Somchem (Somerset West facility) for the 28th time;
- Somchem (Krantzkop facility) for the 20th time;
- Naschem obtained a NOSCAR grading for the 27th time; and
- Pretoria Metal Pressings obtained a NOSCAR Platinum grading.

Several divisions implemented the standard NOSA Safety and Health Management System (Green grading).

- LIW, Swartklip and Dendustri obtained a 5 Star Platinum grading;
- La Forge and Irenco obtained a 4 Star grading; and
- Vektor obtained a 3 Star grading.

Somchem's Somerset West factory was awarded the NOSA Top 100 International award for compliance to SHE management.

ISO 14001 STANDARD ON ENVIRONMENTAL MANAGEMENT SYSTEMS

Denel believes that the implementation of the ISO 14001 Standard on Environmental Management Systems will ensure the control and continual reduction of environmental effects.

Denel Aerospace Systems, La Forge, LIW, Naschem, OTB, PMP, Swartklip, Vektor and both Somchem facilities are ISO 14001 certified.

DISABLING INCIDENTS

Many divisions in Denel achieved excellent records of hours worked without a Disabling Incident (DI).

- Denel Aerospace Systems worked 3 130 992 hours without a DI.
- LIW worked 1 000 000 hours without a DI.

TEN-YEAR REVIEW

	2004 R millions	2003 R millions	2002 R millions
INCOME STATEMENT			
Gross revenue	**4 442,2**	4 372,4	3 904,3
Profit/(loss) on ordinary activities before interest	**62,2**	203,2	(285,8)
Finance costs (before capitalised interest)	**120,0**	109,0	55,0
Depreciation	**121,0**	107,2	95,9
Profit/(loss) on ordinary activities before taxation	**(357,6)**	(43,6)	(347,8)
Profit/(loss) on activities	**(384,4)**	(72,2)	(358,8)
Taxation	**26,8**	28,6	11,0
Minorities interest	**(6,9)**	0,4	4,4
Dividends	**–**	–	–
Cash flow before financing activities	**(200,8)**	(229,0)	(290,7)
BALANCE SHEET			
Non-current assets (refer note)	**1 349,6**	1 414,8	1 243,9
Current assets	**2 742,3**	2 839,2	2 756,7
Total assets	**4 091,9**	4 254,0	4 000,6
Current liabilities	**2 346,8**	1 960,0	2 543,4
Total capital employed	**1 745,1**	2 294,0	1 457,2
Capital and reserves	**834,5**	1 368,3	1 397,6
Minority interest	**9,2**	20,0	18,1
Non-current borrowings	**832,1**	840,9	26,9
STATISTICS			
Average number of shares in issue (millions)			
Class A ordinary shares	**401,9**	401,9	401,9
Class B ordinary shares (refer note)	**40,3**	40,3	40,3
Total shares	**442,2**	442,2	442,2
SHARE PERFORMANCE			
Per share (cents)			
Earnings	**(85,4)**	(16,4)	(82,2)
Headline earnings	**(76,1)**	(9,0)	(28,5)
Ordinary dividends	**–**	–	–
Shareholders' interest	**188,7**	309,4	316,1
Ordinary dividend cover (times)	**–**	–	–
RETURNS (%)			
Operating profit to turnover	**1,4**	4,6	(7,2)
Operating profit to average total assets	**1,5**	4,8	(7,3)
Profit to average ordinary shareholders' interest	**7,5**	14,9	(20,4)
RATIOS			
Debt/equity ratio	**3,8**	2,0	1,8
Current asset ratio	**1,2**	1,4	1,1
Finance cost cover	**(3,0)**	(0,4)	(6,3)
Average number of employees	**10 925**	10 878	10 768

Note

There was a capital redemption on 31 March 1995 of R748,9 million and consists of 167 544 253 Class B ordinary shares.

2001	2000	1999	1998	1997	1996	1995
R millions	R millions	R millions	R millions	R millions	R millions	R millions
3 621,1	3 445,9	3 271,8	3 177,4	3 013,2	3 401,4	3 014,5
41,6	(219,9)	(791,6)	(537,4)	(72,4)	276,5	198,4
8,4	30,8	20,7	12,6	18,3	25,9	29,0
97,6	108,9	113,2	137,5	152,4	118,6	165,6
38,9	(191,2)	(728,5)	(394,3)	94,6	442,0	324,9
26,7	(203,7)	(742,0)	(378,1)	83,9	391,6	310,5
12,2	12,5	13,5	(16,8)	10,6	46,9	64,7
2,6	2,4	3,2	4,1	2,4	13,1	0,3
–	–	–	–	20,0	100,0	70,0
(354,5)	(78,6)	(644,9)	(383,7)	(216,3)	(224,1)	329,4
1 167,1	1 095,5	1 137,2	1 058,2	1 903,2	1 981,1	2 256,0
2 686,8	2 731,5	2 688,1	3 294,7	2 349,6	2 403,2	1 817,5
3 853,9	3 827,0	3 825,3	4 352,9	4 252,8	4 384,3	4 073,5
1 958,3	1 896,5	1 548,8	1 267,1	871,6	1 009,8	736,5
1 895,6	1 930,5	2 276,5	3 085,8	3 381,2	3 374,5	3 337,0
1 760,8	1 736,7	1 942,8	2 687,8	3 064,6	2 992,8	2 707,7
13,1	10,6	10,6	9,3	15,4	13,4	1,1
4,4	1,2	96,6	98,6	103,1	103,1	203,1
401,9	401,9	401,9	401,9	401,9	401,9	401,9
40,3	40,3	40,3	40,3	40,3	40,3	40,3
442,2	442,2	442,2	442,2	442,2	442,2	442,2
5,5	(46,6)	(168,6)	(86,4)	18,4	85,6	70,2
(5,8)	(35,9)	(98,8)	(25,2)	14,3	65,9	57,1
–	–	–	–	4,5	22,6	15,8
398,2	392,7	441,7	609,9	696,5	676,8	612,3
–	–	–	–	4,1	3,8	4,4
1,1	(6,4)	(24,2)	(16,9)	(2,4)	8,1	6,6
1,1	(5,7)	(20,7)	(12,3)	(1,7)	6,3	4,9
2,4	(11,1)	(31,9)	(13,2)	2,8	13,9	9,0
1,1	1,1	0,8	0,5	0,3	0,4	0,3
1,4	1,4	1,7	2,6	2,7	2,4	2,5
4,6	(6,2)	(35,2)	(31,3)	5,2	17,1	11,2
10 375	11 090	12 471	13 700	14 200	14 150	13 826

VALUE ADDED STATEMENT

FOR THE YEAR ENDED 31 MARCH 2004

Value added is a measure of the wealth that the Group has created in its operations by adding value to the cost of materials and services purchased.

The statement shows how wealth was created and how it was shared amongst employees, the providers of funds and the capital reinvested in the Group for continuation and expansion of operations.

	2004		2003	
	R millions	**%**	R millions	%
Gross revenue	**4 442,2**		4 372,4	
Less: Cost of materials and services purchased	**(2 479,3)**		(2 461,3)	
Value added	**1 962,9**		1 911,1	
Add: Income from investments	**(15,2)**		(5,5)	
Other income/(losses)	**(98,6)**		12,2	
Wealth created	**1 849,1**		1 917,8	
Distributed as follows:				
Employees: Salaries and relevant costs	**1 901,6**	**102,8**	1 713,3	89,3
Providers of capital	**105,0**	**5,7**	102,7	5,3
Interest on borrowings	**111,9**	**6,1**	102,3	5,3
Dividends	**–**	**–**	–	–
Minority shareholders' interest	**(6,9)**	**(0,4)**	0,4	–
Government				
Taxation*	**98,9**	**5,3**	66,0	3,4
Reinvested in the Group for continuation and expansion	**(256,4)**	**(13,8)**	35,8	2,0
Depreciation	**121,0**	**6,5**	107,2	5,6
Capitalised development cost amortised	**0,1**	**–**	1,2	0,1
Retained profit/(loss)	**(377,5)**	**(20,3)**	(72,6)	(3,7)
Wealth distributed	**1 849,1**	**100,0**	1 917,8	100,0

	2004	2003
	R millions	R millions
*** TAXATION**		
Taxation paid and provided for	**98,9**	66,0
Company taxation obligations	**26,2**	28,6
Regional Service Council levies	**9,8**	7,5
Rates and taxes paid to local authorities	**32,8**	29,5
Ad valorem excise duties	**30,1**	0,4
Customs and excise duties included in cost of materials and services purchased	**0,6**	9,9
	99,5	75,9
The total amount reflected above excludes the following amounts collected by the Group on behalf of Government:	**186,1**	274,2
Net VAT	**(79,7)**	(13,6)
Charged on sales	**287,7**	415,7
Levied on purchases	**(367,4)**	(429,3)
Employees' taxation	**254,4**	275,9
UIF contributions	**11,4**	11,9

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDER OF DENEL (PROPRIETARY) LIMITED

We have audited the Company and the Group annual financial statements of Denel (Proprietary) Limited set out on pages 48 to 97 for the year ended 31 March 2004. These financial statements are the responsibility of the company's directors. Our responsibility is to express an opinion on these financial statements based on our audit.

SCOPE

We conducted our audit in accordance with statements of South African Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:
- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessing the accounting principles used and significant estimates made by management; and
- evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

AUDIT OPINION

In our opinion, the financial statements fairly present, in all material respects, the financial position of the Company and the Group at 31 March 2004, and the results of their operations and cash flows for the year then ended in accordance with statements of Generally Accepted Accounting Practice in South Africa, and in the manner required by the South African Companies Act of 1973.

SizweNtsaluba VSP Inc

SizweNtsaluba VSP Inc
Chartered Accountants (SA)
Registered Accountants and Auditors
Johannesburg

3 August 2004

Ernst & Young

Ernst & Young
Chartered Accountants (SA)
Registered Accountants and Auditors
Johannesburg

3 August 2004

STATEMENT OF RESPONSIBILITY

The Directors have pleasure in presenting their report and audited financial statements for the year ended 31 March 2004.

The Directors are responsible for the preparation, integrity and fair presentation of the financial statements of Denel (Pty) Limited and its subsidiaries. The financial statements presented on pages 48 to 97 have been prepared in accordance with South African Generally Accepted Accounting Practice, and include amounts, based on judgements and estimates made by management. The Directors supervised the presentation of information included in the annual report and are responsible for both its accuracy and its consistency with the financial statements.

The going concern basis has been adopted in preparing the financial statements. The Directors have no reason to believe that the Company or the Group will not be a going concern in the foreseeable future based on forecasts and cash resources. The financial statements support the viability of the Company and the Group.

The external auditors are responsible for independently auditing and reporting on the financial statements. The unqualified report of independent auditors appears on page 47. Three firms audit the Group jointly and the audit firms for the current year are as follows:

- Ernst & Young (joint lead auditors)
- SizweNtsaluba VSP Inc (joint lead auditors)
- Ngubane & Co (subsidiaries and divisional auditors)

The external lead auditors are engaged to express an independent opinion on the fair presentation of the financial statements on the basis of the results of their audit.

During the year under review the Board of Directors retained full and effective control over the Company and monitored management in implementing Board plans and strategies.

In the opinion of the directors, based on the information available to date, the annual financial statements fairly present the financial position of Denel (Pty) Limited and its subsidiaries at 31 March 2004 and the results of their operations and cash flows for the year then ended, and that the Code of Corporate Practices has been adhered to.

The Group annual financial statements and for the year ended 31 March 2004, set out on pages 48 to 97, were approved by the Board of Directors on 3 August 2004 in terms of the Public Finance Management Act and the Companies Act and are signed on their behalf by:

SDM Zungu
Chairman

ZP Manase (Ms)
Chairperson of the Board Audit Committee

THE GROUP

Denel (Pty) Limited was established on 1 April 1992 as a private company, incorporated in terms of the Companies Act with the State as the sole shareholder. Denel (Pty) Limited is a listed public entity in terms of the Public Finance Management Act No 1 of 1999.

NATURE AND OBJECTIVES OF THE BUSINESS

NATURE OF THE BUSINESS

Denel is a technology-based company with a strong emphasis on high technology research and development. It is involved in research and development, engineering and manufacturing, and supports its products through their entire life cycle.

Denel's key capabilities include systems development and production across a number of engineering disciplines. To this end Denel maintains a number of dedicated system houses, which maintain responsibility for their own in-house specialist product research and technology development.

PLANNING POLICY

A five-year business plan setting out Denel's strategic direction is developed with key stakeholders using information from all divisions and business units. The Board of Directors and the Executive Committee approve the business plan with predetermined strategic and operational objectives.

Annual budgets are based on the strategic direction set out in the five-year business plan. The annual budget is approved a month before the start of the new financial year in compliance with provisions of the Public Finance Management Act.

The key performance areas and indicators are used to measure performance against the budget and are reported on a regular basis to the Board of Directors, the Executive Committee and divisional business report meetings. These objectives and indicators are discussed in detail in this Directors' report to provide strategic insight into the sustainability and improvement of performance.

CONSEQUENCES OF THE STRENGTHENING OF THE RAND

Management has successfully transformed the Group from a locally focused group serving mainly the SANDF into a global group with the majority of its revenue being generated from exports. A substantial number of the Group's business is contracted in US dollars with countries around the world and export sales have grown from 56% to 58% of total sales of the Group. Therefore, the performance of the Group is susceptible to the currency risk resulting from the volatility of the South African rand against major currencies.

The relative strengthening of the SA rand against the currencies of its trading partners, particularly from the last two trading quarters of the 2003 financial year, has had a negative impact on the Group's revenues and this trend has continued into the 2004 financial year.

The strengthening of the SA rand against the US dollar, from a budget target of US dollar/R9,6 to an actual average of US dollar/R7,1 (decrease of 26%) has affected the Group's results substantially. Directors and management, taking into account the continued strength of the SA rand, have as far as possible structured their export business to counter volatility of the SA rand and also embarked on major programmes to enhance efficiency.

The Group's policy is to hedge its foreign commitments through the use of appropriate derivative instruments. The dramatic strengthening of the rand against the other currencies and the implementation of AC133 has resulted in the Group recording significant foreign currency losses.

OVERVIEW OF PERFORMANCE AGAINST OBJECTIVES

The financial performance against targets was to a large extent influenced negatively by the following:

- Strengthening of the SA rand against the US dollar, from a budget targeted exchange rate of US dollar/R9,6 to an actual average of US dollar/R7,1.
- Implementation of AC133, which had a negative impact of R112,9 million on profit for the year.

An overview of Denel's performance against set objectives is contained in the following table:

Objectives	Key performance indicators	Performance results
1. Business restructuring	• Obtain a strategic equity partner for Denel (Pty) Limited.	• Denel concluded strategic partnerships/alliances with international companies identified in niche areas. The South African Government is continuing to seek international partners for Denel, which can add value to the business.
	• Exiting of remaining non-core businesses. These are Sybase SA, Irenco and SPP.	• Exit processes have started but there have been delays in exiting identified non-core businesses. The process to exit the businesses of SPP (Pty) Limited, Irenco (Pty) Limited and Sybase SA will proceed during the 2004/5 financial year.
	• Completing turnaround and rightsizing of loss-making divisions with the main focus on Somchem, Vektor and Denel Aviation.	• Somchem has been turned around and is now profitable. Vektor is currently in the process of rightsizing and being incorporated into LIW. The Aerospace businesses that include Denel Aviation have been restructured. Additionally Denel Aviation is in the process of rightsizing. The restructured businesses were operational with effect from 1 April 2004. It is expected that the rightsizing processes will be finalised by 31 August 2004.
	• Implementation of tighter controls on key projects such as Rooivalk.	• All major projects have been ringfenced and tight controls implemented. Future cash flow on Rooivalk is planned to be positive.
2. Risk	• Maintain ISO 14001 and ISO 9000 certification and improve compliance with specified standards.	• A number of divisions are certified and have improved their compliance with the specified standards.
3. Human resource development	• Improving employment equity at executive and senior management levels.	• The number of historical disadvantaged individual (HDI) executives and senior managers increased from 35 in 2002/03 to 65 in 2003/04. Gender representation has increased from 4 in 2002/03 to 25 in 2003/04.
	• Implementing a training strategy and plan for divisions. Spend 3% on average of salary bill in 80/20 allocation of training budget.	• A focused training programme has been developed. We have spent an amount of R57,8 million (2003: R17,9 million) on training and development, including skills and technology training, in the Denel Training Academy and Kentron Bridging School.

Objectives	Key performance indicators	Performance results
4. Social investment	• Improvement on social investment and human resource development expenditure.	• An amount of R2,9 million was spent on corporate social investment programmes.
	• External bursaries awarded.	• Bursaries of R4,3 million (2003: R3,9 million) to students studying engineering and other related courses.
5. Market share	• Grow business and turnover by 5%.	• Turnover grew by 1,6%. Growth in US dollar terms exceeded the target.
	• Increase the export market turnover share from 53,7% to 60,4% in 2003/2004, and increase exports by 10%.	• Export sales as a percentage of total revenue increased from 55,6% (2003) to 58,1% in the year ended 31 March 2004. In US dollar terms the target has been achieved.
	• Conclude a major artillery export order.	• No major contract concluded yet. Negotiations are in an advanced stage with relation to a potential artillery export order.
	• Grow Aerospace business by 5% per year in real terms, with a contribution to profits for the Group.	• Negative growth 8,2% in SA rand terms due to restructuring of the business and the foreign exchange impact.
6. Financial performance 6.1 Revenue	• Increase gross revenue in real terms by 10% year-on-year.	• Gross revenue from continuing operations increased by 6,7% from R4 163,2 million (2003) to R4 442,2 million in the year ended 31 March 2004. The strengthening of the SA rand against the US dollar had a negative impact on potential revenue growth. Growth in US dollar terms exceeded the 10% target.
6.2 Profitability	• Improve gross profit margins to 30% over the next five years.	• Gross profit margins reduced from 29,2% (2003) to 29,0% in 2004 due to the rate of exchange and certain loss-making entities.
6.3 Cost efficiency	• Improve the ratio of operating cost to revenue, by at least 5%.	• The ratio of operating cost relative to revenue deteriorated from 25,6% (2003) to 26,0 % (2004). Actual costs increased by 3,2% for the year. The ratio was influenced by lower SA rand values of revenue due to the rate of exchange movement.
6.4 Net profit	• Improve the net profit by 10% in the financial year ended 31 March 2004.	• A loss before tax of R357,6 million was recorded at 31 March 2004, of which R112,9 million was related to the adoption of AC133 (R43,6 million loss 2003).
6.5 Cash flow	• Improve cash flow position of the Group, with an operating cycle of 10%.	• Cash flow before financing was an outflow of R200,8 million (2003: Outflow of R229,0 million).

BUSINESS RESTRUCTURING

Denel continued with the restructuring programme that was started in the 1999/2000 financial year. Denel has successfully turned around some of the loss-making divisions into sustainable businesses. These include Somchem, Mechem, and PMP. Focus in the coming year will be on exiting remaining non-core and loss-making businesses, and internal restructuring to ensure efficiency.

Strategic partnerships and alliances have been concluded with international companies to ensure both access to business opportunities and niche technologies. Denel has alliances with DIEHL MUNITIONS of Germany for artillery ammunition for NATO in Europe, GD-OTS of the USA for artillery ammunition for the USA market, and Radway Green of the United Kingdom for the supply of brass cups and discs. Other alliances are being considered.

HUMAN RESOURCES DEVELOPMENT

In the current financial year, Denel spent R57,8 million on training and development of its employees. On an average 3% of the payroll had been allocated for people development initiatives. In addition, Denel offered bursaries to the tune of R4,3 million to students studying engineering and other related courses at tertiary institutions. Our bridging programme, through the Kentron Bridging School, cost the company R2,4 million.

In the new financial year, all education, training and development in Denel will be centralised into the Denel Centre for Learning and Development (DCLD). The DCLD has four Schools (Business Leadership, Marketing and Management; Aerospace, Land Systems and Denel Youth Foundation Training Programme). In addition, the DCLD has appointed a Quality Assurance Manager to ensure that all programmes offered are of the highest quality, that Denel meets the legal requirements for training in the industry, and a Learnerships Manager to co-ordinate skills development in the company with skills development facilitators (SDFs). All bursaries will also be co-ordinated from the DCLD, thus ensuring that we adequately meet the future skills needs of the company.

SOCIAL INVESTMENT

The Group is committed to investing in the community from which it operates and developing SMMEs, especially those belonging to previously disadvantaged individuals. A total of R2,9 million was spent on corporate social investment programmes as follows:

• Primary health care	R577 291
• Education and training	R275 235
• Community development	R2 060 049

MARKET PROFILE

Denel increased its export drive. Export opportunities have been identified worldwide and are being pursued. Export sales comprise 58,1% (2003: 55,6%) of the Group's total sales.

In an effort to increase its market share, Denel increased export sales by 6,3% from R2 429,0 million in 2002/2003 to R2 581,6 million in 2003/2004. The increase in export sales in SA rand terms was negatively affected by the strengthening of the SA rand against the major foreign currencies.

FINANCIAL PERFORMANCE

The financial results for the year ended 31 March 2004 are set out in the accompanying abridged income statement. The Group loss before tax amounted to R357,6 million. The impact of the implementation of AC133 on profit is demonstrated. Although the impact of AC133 is significant, it was limited due to the Group's conservative Treasury policy. (Refer to "Consequences of the strengthening of the rand" on page 49.)

Comparison between results reported and the reported results, excluding of AC133.

Consolidated income statement for year ended 31 March 2004

	As reported R millions	**Excluding AC133 R millions**	**Impact R millions**
Revenue	**4 442,2**	**4 073,9**	**368,3**
Cost of sales	**(3 154,9)**	**(3 121,9)**	**(33,0)**
Gross profit	**1 287,3**	**952,0**	**335,3**
Other income	**71,4**	**71,4**	**–**
Operating expenses	**(1 154,2)**	**(1 156,2)**	**2,0**
Operating profit/(loss)	**204,5**	**(132,8)**	**337,3**
Items disclosed separately	**(142,3)**	**(142,3)**	**–**
Operating profit/(loss) before borrowing costs	**62,2**	**(275,1)**	**337,3**
Finance costs	**(127,1)**	**(129,1)**	**2,0**
Foreign exchange (losses)/gains	**(254,5)**	**197,7**	**(452,2)**
Share of results of associates	**(38,2)**	**(38,2)**	**–**
Loss before taxation	**(357,6)**	**(244,7)**	**(112,9)**

The significant strengthening of the rand against other major currencies during the year under review resulted in an embedded forward exchange liability. The accounting statement AC133 requires that the impact of foreign currency changes and time be reflected in the financial statements in instances where purchase or sales contracts are in currencies that are neither the functional currency of the buyer or seller. The embedded forward exchange contracts should not have a significant detrimental impact on the Group should the rand remain stable.

Despite difficult trading conditions the majority of the divisions performed well. The results were, however, influenced negatively by specific businesses that are to be exited, restructured and/or rightsized.

The directors are of the opinion that due to the integrated nature of the Group activities, separate reporting on financial results of the various operations will be of no value.

GOING CONCERN

The financial statements have been prepared on the going concern basis.

During the 2003/2004 financial year and between the financial year-end and the date of this report, the Board approved programmes to discontinue, exit or rightsize a number of operations that consistently failed to achieve set targets and have been responsible for major cash outflow and losses in the Group. The Board is of the opinion that the balance sheets of the Group and the Company are still healthy and contain assets with high value.

During 2002/2003 Denel raised an amount R825 million through its bond issue, with the aim of constantly lowering the long-term cost of debt. During the year short-term finance facility was arranged for R500 million through the Commercial Paper Programme and was approved in April 2004. Only R250 million of this facility was accessed after the balance sheet date.

PROPERTY, PLANT AND EQUIPMENT

Movements in the value of property, plant and equipment of the Group are reflected in note 9 to the financial statements. There is no change in policy regarding the application thereof.

In the opinion of the Board of Directors, the carrying value of property, plant and equipment of the Group represents the recoverable value when assessed in total and on the going concern basis.

CAPITALISED DEVELOPMENT COST

Movements in the capitalised development cost of the Group are reflected in the financial statements.

ADVANCES AND PREPAYMENTS MADE

The recoverability of the carrying value of the advances and prepayments made is connected to the successful finalisation of relevant contracts.

SHARE CAPITAL AND PREMIUM

There has been no change in the authorised and issued share capital of the Company. The directors do not have the authority to issue shares of the Company. The unissued share capital is under the control of the South African Government, being the sole shareholder.

DIVIDEND

No dividend is recommended for 2003/2004.

RETIREMENT BENEFITS

PENSION AND PROVIDENT SCHEMES

All qualifying employees are members of either an independent pension or retirement fund.

The Denel Pension Fund is a closed defined benefit pension fund, with 97,9% of its members being pensioners and is governed by a Board of Trustees in terms of the Pension Funds Act (Act No 24 of 1956). The Fund is actuarially valued at intervals of three years or as deemed necessary by the Board of Trustees. The most recent valuation, performed on 31 December 2001, confirmed that the Fund was financially sound. No unusual events that could have impaired the solvency of the Fund have taken place since this valuation.

The Denel Retirement Fund is a defined contribution pension fund, governed by a Board of Trustees in terms of the Pension Funds Act (Act No 24 of 1956). The Fund is actuarially valued at intervals of three years or as deemed necessary by the Board of Trustees.

The employer utilised a contribution holiday of R52,8 million (2003: R75,2 million) and the contribution holiday ended on 1 September 2003.

POST-RETIREMENT MEDICAL BENEFITS

The Denel Group provides post-retirement medical aid contribution subsidies to qualifying retirees. The expected liabilities of these subsidies are assessed by a qualified actuary and are funded off-balance sheet in the Denel Medical Benefit Trust. An actuarial valuation of the assets and liabilities confirms that the assets in the Denel Medical Benefit Fund exceed the past service liability as at 31 March 2004. As such, no additional provision is deemed necessary.

PUBLIC FINANCE MANAGEMENT ACT (PFMA)

PFMA compliance is one of the key business risks that the Group manages and monitors. Group internal audit has incorporated testing compliance with PFMA provisions in its audit programme and reports its findings to the Audit Committee.

Section 51 and section 55 of the Public Finance Management Act contain certain onerous obligations for the Company to comply with, regarding the prevention, identification and reporting of any irregular expenditure and fruitless and wasteful expenditure. Denel has not yet been able to introduce systems and have controls in place to meet these stringent requirements. As a consequence Denel is technically not fully in compliance with all the requirements of the PFMA. However, the Board does not consider that there are any instances of material nature that contravened sections 51 and 55.

A materiality and significant framework is currently being developed for reporting material losses through criminal conduct and irregular, fruitless and wasteful expenditure as well as for significant transactions that require reporting to the Minister as envisaged in section 54(2) of Public Finance Management Act. The framework will be formulated, discussed with external auditors and formally approved by the Minister.

The Board of Directors does not consider that there were any instances of material losses through criminal conduct and irregular, fruitless and wasteful expenditure. Section 54(2) of the PFMA has been complied with, where applicable.

DIRECTORS AND SECRETARY

In terms of the provisions of the Articles of Association of the Company, the Minister of Public Enterprises, acting on behalf of the shareholder, appoints the Board.

The composition of the Board during the year was as follows:

- SDM Zungu (Chairperson)
- VGM Moche (Chief Executive Officer: appointed with effect from 1 May 2003)
- Dr DE Baloyi
- I Deetlefs
- Ms ZP Manase
- ET Mazwai
- Dr KDK Mokhele
- Lt-Gen L Moloi (Ret)
- AT Mukoki
- Dr IM Phillips
- HD du P Potgieter (Executive Director)
- Dr CJ Saunders
- Dr SP Sibisi
- MV Sisulu (Executive Director – resigned on 31 October 2003)
- MC Jita (Executive Director – resigned on 31 December 2003)

DIRECTORS' EMOLUMENTS

The following amounts were either paid or accrued to the Directors during the year:

Executive Directors

Directors' emoluments	Total R'000	Remu-neration R'000	Allowances R'000	Loss of office R'000	Contributions made: pension and medical R'000
VGM Moche	1 459	1 132	182	–	145
MV Sisulu	2 738	520	97	2 042	79
MC Jita	870	668	122	–	80
HD du P Potgieter	1 202	898	154	–	150
Total	6 269	3 218	555	2 042	454

No performance or other bonuses were paid or are payable. During the year R1 079 580 was paid to the previous employer of Mr Moche. This amount represents a retention amount relating to a 36-month period. He will be liable to refund the Company this amount in proportion to the unexpired term of service, including interest at the current rate used by the South African Revenue Services, should he resign before the end of the 36-month period.

Non-executive Directors

Directors' emoluments	Fees R'000
SDM Zungu	663
DE Baloyi	37
I Deetlefs	34
ZP Manase	17
ET Mazwai	36
KDK Mokhele	43
L Moloi	47
AT Mukoki	20
IM Philips	44
CJ Saunders	37
SP Sibisi	25
Total	1 003

POST-BALANCE SHEET EVENTS

Between the balance sheet date and the date on which the financial statements were authorised for issue no major decisions affecting the Group were taken.

Company Secretary, Dr TJ van Reenen

The business and postal addresses:

Denel Building	PO Box 8322
Jochemus Street	Centurion
Erasmuskloof	0046

CONSOLIDATED BALANCE SHEETS

AT 31 MARCH 2004

GROUP R millions 2004	GROUP R millions 2003		Notes	COMPANY R millions 2004	COMPANY R millions 2003
		ASSETS			
1 349,6	1 414,8	**Non-current assets**		**1 276,3**	1 355,0
695,3	709,8	Property, plant and equipment	9	**578,0**	568,9
331,4	301,8	Investment property	10	**99,7**	76,1
27,4	65,6	Intangible assets	11	**27,3**	65,2
–	–	Investments in subsidiaries	12	**318,6**	351,6
210,6	253,0	Investments in associates	13	**197,6**	239,3
36,9	41,9	Other investments	14	**36,9**	41,6
48,0	42,7	Deferred tax assets	15	**18,2**	12,3
2 742,3	2 839,2	**Current assets**		**2 483,8**	2 574,6
1 322,1	1 285,7	Inventories	16	**1 249,0**	1 194,1
903,7	1 061,0	Receivables and prepayments	17	**781,7**	953,0
221,8	49,9	Derivative financial asset	18.1	**221,8**	49,9
294,7	442,6	Cash and cash equivalents	19	**231,3**	377,6
4 091,9	4 254,0	**Total assets**		**3 760,1**	3 929,6
		EQUITY AND LIABILITIES			
834,5	1 368,3	**Capital and reserves**		**642,9**	1 181,1
442,2	442,2	Share capital	20	**442,2**	442,2
1 534,2	1 534,2	Share premium	20	**1 534,2**	1 534,2
45,5	45,2	Non-distributable reserves		**43,3**	43,3
(1 187,4)	(653,3)	Retained earnings		**(1 376,8)**	(838,6)
9,2	20,0	**Minority interest**	21	**–**	–
901,4	905,7	**Non-current liabilities**		**866,5**	869,7
832,1	840,9	Interest-bearing borrowings	22	**829,8**	837,3
20,7	22,1	Non-current provisions	23	**18,5**	20,1
48,6	42,7	Deferred tax liabilities	15	**18,2**	12,3
2 346,8	1 960,0	**Current liabilities**		**2 250,7**	1 878,8
592,4	657,9	Trade payables and other payables	24	**549,5**	613,7
461,8	4,2	Derivative financial liability	18.2	**461,8**	4,2
75,7	8,7	Current interest-bearing borrowings	22	**74,3**	7,1
768,4	847,5	Advance payments received		**765,1**	844,3
437,9	436,0	Current provisions	23	**400,0**	409,5
10,6	5,7	Current tax liabilities		**–**	–
4 091,9	4 254,0	**Total equity and liabilities**		**3 760,1**	3 929,6

CONSOLIDATED INCOME STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2004

GROUP R millions 2004	GROUP R millions 2003		Notes	COMPANY R millions 2004	COMPANY R millions 2003
4 442,2	4 372,4	REVENUE	2	**4 141,6**	3 993,9
4 442,2	4 163,2	Continuing		**4 141,6**	3 898,8
–	209,2	Discontinuing	6	**–**	95,1
(3 154,9)	(3 096,1)	COST OF SALES	3	**(2 977,5)**	(2 820,5)
1 287,3	1 276,3	GROSS PROFIT		**1 164,1**	1 173,4
71,4	61,2	OTHER INCOME		**61,8**	60,4
(1 154,2)	(1 118,3)	OPERATING EXPENSES	3	**(993,5)**	(962,6)
204,5	219,2	OPERATING PROFIT BEFORE SEPARATELY DISCLOSED ITEMS		**232,4**	271,2
(0,3)	11,4	Profit/(loss) on discontinuing operations	6	**(0,3)**	11,4
(22,9)	10,3	Retrenchment costs		**(22,9)**	10,3
(64,7)	–	Development expenses	3	**(64,7)**	–
(4,3)	1,9	Products recall		**(4,3)**	1,9
–	–	Impairment of investments in subsidiary	12	**(107,4)**	(124,3)
(11,7)	–	Impairment of investment in associated companies	13	**(49,4)**	–
–	(15,7)	Impairment of goodwill	11	**–**	–
(38,2)	(30,0)	Impairment of property, plant and equipment	9	**(25,7)**	–
(15,5)	–	Impairment of inventories	16	**–**	–
(6,7)	–	Provision of contract risk	16	**–**	–
22,0	6,1	Fair value adjustment of investment properties	10	**23,8**	–
62,2	203,2	OPERATING PROFIT BEFORE BORROWING COSTS		**(18,5)**	170,5
62,2	224,3	Continuing		**(18,5)**	191,3
–	(21,1)	Discontinuing	6	**–**	(20,8)
(127,1)	(107,8)	Finance charges	4	**(117,5)**	(93,4)
(254,5)	(151,9)	Foreign exchange loss	5	**(250,4)**	(155,9)
–	–	Dividend received		**5,4**	272,2
(38,2)	12,9	Share of results of associates	13	**–**	–
(357,6)	(43,6)	(LOSS)/PROFIT BEFORE TAXATION		**(381,0)**	193,4
(26,8)	(28,6)	Taxation	7	**(0,2)**	(18,4)
(384,4)	(72,2)	(LOSS)/PROFIT AFTER TAXATION		**(381,2)**	175,0
6,9	(0,4)	Minorities interest	21	**–**	–
(377,5)	(72,6)	NET (LOSS)/PROFIT		**(381,2)**	175,0
Cents	Cents				
(85,4)	(16,4)	Earnings per share	8		
(76,1)	(9,0)	Headline earnings per share	8		

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 MARCH 2004

	Notes	Share capital R millions	Share premium R millions	Revaluation reserves R millions	Contingency reserves* R millions	Accumulated losses R millions	Total R millions
GROUP							
2003							
Balance at 1 April 2002		442,2	1 534,2	6,5	1,6	(586,9)	1 397,6
Net loss		–	–	–	–	(72,6)	(72,6)
Revaluation of property, plant and equipment		–	–	43,3	–	–	43,3
Transfers to/(from) accumulated losses		–	–	(6,4)	0,2	6,2	–
Balance at 31 March 2003	20	442,2	1 534,2	43,4	1,8	(653,3)	1 368,3
2004							
Balance at 1 April 2003		**442,2**	**1 534,2**	**43,4**	**1,8**	**(653,3)**	**1 368,3**
Adjustment due to AC133 adoption		**–**	**–**	**–**	**–**	**(157,0)**	**(157,0)**
Adjusted opening balance at 1 April 2003		**442,2**	**1 534,2**	**43,4**	**1,8**	**(810,3)**	**1 211,3**
Net loss		**–**	**–**	**–**	**–**	**(377,5)**	**(377,5)**
Transfer from minorities		**–**	**–**	**–**	**–**	**0,7**	**0,7**
Transfers to/(from) accumulated losses		**–**	**–**	**–**	**0,3**	**(0,3)**	**–**
Balance as at 31 March 2004	20	**442,2**	**1 534,2**	**43,4**	**2,1**	**(1 187,4)**	**834,5**
COMPANY							
2003							
Balance at 1 April 2002		442,2	1 534,2	–	–	(1 013,6)	962,8
Net loss		–	–	–	–	175,0	175,0
Revaluation of property, plant and equipment		–	–	43,3	–	–	43,3
Balance at 31 March 2003	20	442,2	1 534,2	43,3	–	(838,6)	1 181,1
2004							
Balance at 1 April 2003		**442,2**	**1 534,2**	**43,3**	**–**	**(838,6)**	**1 181,1**
Adjustment due to AC133 adoption		**–**	**–**	**–**	**–**	**(157,0)**	**(157,0)**
Adjusted opening balance at 1 April 2003		**442,2**	**1 534,2**	**43,3**	**–**	**(995,6)**	**1 024,1**
Net loss		**–**	**–**	**–**	**–**	**(381,2)**	**(381,2)**
Balance at 31 March 2004	20	**442,2**	**1 534,2**	**43,3**	**–**	**(1 376,8)**	**642,9**

** In terms of the Short-term Insurance Act, Densecure (Pty) Limited is required to raise a contingency reserve of 10% of premiums written less approved reinsurance (as defined in the Short-term Insurance Act, 1998). The reserve can be utilised only with prior permission of the Registrar of Insurance.*

CONSOLIDATED CASH FLOW STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2004

GROUP R millions 2004	GROUP R millions 2003		Notes	COMPANY R millions 2004	COMPANY R millions 2003
(54,7)	8,1	CASH FLOWS FROM OPERATING ACTIVITIES		**2,2**	41,2
4 541,5	4 490,6	Cash receipts from customers		**4 239,8**	4 144,6
(4 492,0)	(4 381,3)	Cash paid to suppliers and employees		**(4 164,7)**	(4 303,7)
49,5	109,3	**Cash generated from/(utilised in) operations**		**75,1**	(159,1)
(118,0)	(109,0)	Interest paid		**(133,4)**	(120,0)
27,1	38,7	Interest received		**55,3**	66,5
–	–	Dividend received		**5,4**	272,2
(13,3)	(30,9)	Taxation paid		**(0,2)**	(18,4)
(146,1)	(237,1)	CASH FLOWS FROM INVESTING ACTIVITIES		**(206,8)**	(238,0)
(143,9)	(177,6)	Additions and replacement of property, plant and equipment		**(137,9)**	(161,4)
0,5	5,6	Proceeds on disposal of property, plant and equipment		**2,1**	5,5
(13,2)	(13,5)	Acquisition of investment property		**–**	–
8,0	15,5	Proceeds on disposal of investment property		**–**	–
(25,9)	(26,0)	Capitalised development costs		**(25,7)**	(41,9)
44,9	4,5	Other investments		**37,8**	4,9
–	30,0	Disposal of business		**–**	30,0
–	–	Investments in subsidiaries		**(74,4)**	5,0
(16,5)	(75,6)	Investments in associates		**(8,7)**	(80,1)
(200,8)	(229,0)	CASH FLOW BEFORE FINANCING		**(204,6)**	(196,8)
52,9	467,7	CASH FLOWS FROM FINANCING ACTIVITIES		**58,3**	467,3
(9,5)	(7,8)	Redemption of non-current borrowings	22	**(8,1)**	(7,1)
–	814,0	Non-current borrowings raised		**–**	810,7
66,4	(335,0)	Current borrowings raised/(repaid)		**66,4**	(333,0)
(0,1)	(3,5)	Repayment of bank overdraft		**–**	(3,3)
(3,9)	–	Payment to minorities		**–**	–
(147,9)	238,7	NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		**(146,3)**	270,5
		Cash and cash equivalent			
442,6	203,9	**At the beginning of the year**		**377,6**	107,1
294,7	442,6	**At the end of the year**	19	**231,3**	377,6

NOTES TO THE CASH FLOW STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2004

GROUP R millions 2004	GROUP R millions 2003		Notes	COMPANY R millions 2004	COMPANY R millions 2003
		RECONCILIATION OF PROFIT WITH CASH RETAINED FROM OPERATIONS			
(357,6)	(43,6)	**Net loss before taxation**		**(381,0)**	193,4
437,9	30,3	**Adjusted for:**		**477,3**	(213,5)
121,0	107,2	Depreciation	3	**102,3**	83,1
0,7	2,1	Amortisation of intangible assets	3	**0,2**	0,3
2,0	(2,3)	Loss/(profit) on sale of property, plant and equipment	3	**2,0**	(2,0)
(2,6)	(1,8)	Profit on disposal of investment properties	3	**–**	–
0,3	(11,4)	Loss/(profit) on discontinuing operations	6	**0,3**	(11,4)
83,5	63,6	Net interest paid	4	**73,9**	49,2
–	–	Dividend received		**(5,4)**	(272,2)
16,0	–	Revaluation of derivatives		**16,0**	–
115,5	–	Revaluation of embedded derivatives		**115,5**	–
(29,3)	(153,8)	Provisions		**(50,9)**	(184,8)
–	15,7	Impairment of goodwill	11	**–**	–
64,7	–	Impairment of capitalised development cost		**64,7**	–
38,2	30,0	Impairment of property, plant and equipment		**25,7**	–
–	–	Impairment of investments in subsidiaries		**107,4**	124,3
11,7	–	Impairment of investment in associated companies		**49,4**	–
38,2	(12,9)	Share of results of associates		**–**	–
(22,0)	(6,1)	Fair value adjustment of investment properties		**(23,8)**	–
80,3	(13,3)	**Operation profit/(loss) before changes in net current assets**		**96,3**	(20,1)
(30,8)	122,6	**Changes in net current assets**		**(21,2)**	(139,0)
(66,1)	63,1	(Increase)/decrease in inventories		**(72,0)**	31,5
227,5	55,0	Decrease in current receivables		**234,3**	59,8
(79,1)	46,2	(Decrease)/increase in advance payments received		**(79,2)**	74,7
(47,0)	35,7	(Increase)/decrease in prepayments made		**(39,6)**	28,3
(66,1)	(77,4)	Decrease in payables		**(64,7)**	(333,3)
49,5	109,3	**Cash generated from/(utilised in) operations**		**75,1**	(159,1)

1. ACCOUNTING POLICIES

The annual financial statements of the Company and the Group are compiled in accordance with the historical cost convention, modified by the restatement of financial instruments to fair value, except where otherwise stated.

The principal accounting policies set out below are consistent with those applied in the previous year and comply with South African Statements of Generally Accepted Accounting Practices. The annual financial statements have been prepared in accordance with the requirements of the South African Companies Act.

1.1 BASIS OF CONSOLIDATION

The consolidated annual financial statements reflect the financial position and operating results of the Company, its subsidiaries and associates.

Subsidiaries are companies in which Denel controls the composition of the Board of Directors, or has the power to govern the financial and operating policies of the entity. Typically this will be where Denel holds more than 50% of the voting power or is significantly exposed to the risks of or enjoys the benefits of ownership. Subsidiaries are consolidated from date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal.

All significant intercompany transactions, balances and unrealised gains and losses are eliminated on consolidation.

Associated companies are those companies in which Denel holds an equity interest and over which it has the ability to exercise significant influence, which are not subsidiaries or joint ventures. Investments in associates are accounted for on the equity method of accounting. The Group's share of accumulated retained earnings and movements in the reserves of such companies are included in the Group financial statements from the effective date on which the enterprise became an associate to the date of disposal.

1.2 REVENUE RECOGNITION

- **Sales**

Revenue comprises the invoiced value of the sale of goods and services net of value added tax, rebates and discounts, and after eliminating sales within the Group. Revenue from the sale of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer and the amount of revenue can be measured reliably. Revenue from the rendering of services is recognised based on the stage of completion determined by reference to services performed to date as a percentage of total services to be performed. Where the outcome of service contracts cannot be measured reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable.

- **Income from investment properties**

Income from investment properties mainly comprises rental income received in terms of rental agreements and are recognised as accrued.

- **Interest income on advance payments**

Interest income on advance payments received from customers is recognised as revenue on a monthly basis. Advance payments received directly affects the contract prices negotiated with customers. As a result interest income on the advance payments is directly related to the revenue generated from contracts entered into.

1.3 INTEREST AND DIVIDEND INCOME

Interest is recognised on a time proportion basis, taking account of the principal amount outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the Group. Dividends are recognised when the right to receive payment is established.

1.4 OTHER INCOME

Other income is any income that accrued to the Company or the Group that is not part of the normal operations and is recognised as earned.

1.5 DISCONTINUING OPERATIONS

Discontinuing operations are significant, distinguishable components of the Company that have been sold, abandoned or are the subject of formal plans for disposal.

The profit or loss on the sale or abandonment of a discontinued operation is determined as the difference between the proceeds from the disposal and the net carrying amount of the assets and all costs and expenses directly associated with the disposal or abandonment. If a loss on discontinuance is expected, full provision is made from the date of discontinuance. Conversely, if a profit is anticipated, it is recognised only when realisation of the profit is reasonably certain.

The operational results of the discontinued operations are included in the profit or loss from the ordinary activities of that year.

1.6 PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

The Group recognises the estimated liability on products still under warranty at the balance sheet date. The provision is calculated based on service history. Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to balance sheet date.

1.7 DEFERRED TAX

Deferred tax is provided, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Current enacted tax rates are used to determine deferred tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the unused tax losses and other temporary differences can be utilised.

1.8 FINANCIAL INSTRUMENTS

- **Measurement**

Financial instruments are initially measured at cost, which includes transaction costs. "Regular way" purchases and sales are accounted for at trade date. Subsequent to initial recognition these instruments are measured as set out below.

- **Investments**

Non-current investments are classified as held-for-trading and are measured at fair value. Changes in the fair value are charged or credited to the income statement. Investments in subsidiaries and associates are recognised at cost less impairment in the balance sheet of Denel.

Where an investment has been impaired, the impairment is recognised as an expense in the period in which the impairment is identified.

On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the income statement.

- **Trade and other receivables**

Trade and other receivables are carried at amortised cost. They are individually assessed for impairment on a regular basis. The impairment is the difference between the assets carrying amount and the realisable value. The impairment is included in the net profit or loss for the year. Recovery proceedings are continued and credits are only taken for amounts when actually recovered.

Non-current trade receivables comprise amounts that are contractually deferred for a period longer than twelve months after the date of sale.

- **Interest-bearing borrowings**

Interest-bearing borrowings are initially recognised at cost being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated after having taken into account any issue costs, discounts and premium on settlement.

- **Other financial liabilities**

Other financial liabilities are recognised at amortised cost, namely original debt less principal repayments and amortisation.

- **Derivative financial assets and liabilities**

Derivative financial assets and liabilities, which are traded in an organised financial market are re-measured at the current quoted market bid price for assets held or liabilities to be issued or the offer price for assets to be acquired or liabilities held.

- **Gains and losses on subsequent measurement**

Gains and losses arising from a change in the fair value of financial instruments are included in net profit or loss for the period in which they arise.

- **Offset**

Where a legally enforceable right of set-off exists for recognised financial assets and financial liabilities, and there is an intention to settle the liability and realise the asset simultaneously, or to settle on a net basis, all related financial effects are offset.

1.9 FOREIGN CURRENCIES

- **Recording of foreign transactions**

All foreign exchange transactions are accounted for at the ruling spot rates on the date of the transaction.

When the transaction is settled at a different rate than the rate at which the transaction was recorded, the conversion gains or losses are included in net profit or loss.

- **Translation of foreign monetary items**

All monetary items are translated at year-end at the ruling year-end spot rate. Any gain or loss arising out of the translation at year-end is included in net profit or loss.

- **Recording of foreign exchange contracts and options**

All forward exchange contracts and options are revalued at year-end. Any gain or loss arising out of the revaluation of forward exchange contracts and options are included in net profit or loss, and a financial asset or liability is created and included on the balance sheet.

- **Recording of foreign exchange embedded derivatives**

A foreign exchange embedded derivative is a contract denominated in a foreign currency, which is neither the measurement currency of any party to the contract, nor the currency in which the commodity is routinely traded in international commerce, and therefore contains a foreign exchange embedded derivative (to sell or buy the equivalent amount of foreign currency), is separated and accounted for at fair value. All foreign exchange embedded derivatives are revalued at year-end. Any gain or loss arising out of the revaluation of forward exchange contracts and options are included in net profit or loss, and an embedded derivative asset or liability is created and included in the balance sheet. The embedded derivative asset or liability is released to sales, cost of sales, operating cost or a related asset to reflect a rand host contract at the initial expected forward rate when delivery takes place.

• Foreign entities

Income statements of foreign entities are translated into the Group's reporting currency at average exchange rate for the year and balance sheets are translated at the year-end spot rate.

Material exchange rate differences arising from the translation of the net investment in foreign subsidiaries are recognised in operating profit or loss. On disposal of the foreign entity, such differences are recognised in the income statement as part of the gain or loss on disposal.

1.10 INVESTMENT PROPERTIES

Investment properties, principally comprising office and manufacturing buildings, is held for long-term rental yields and is not occupied by the Group. Investment property is treated as a long-term investment and is carried at fair value, representing open market value, determined annually by external registered appraisers. Changes in fair value are recorded in the income statement.

Where the fair value of an investment property cannot be reliably determined, the investment property is stated at historical cost less accumulated depreciation.

On disposal of an investment property, the difference between the net disposal proceeds and the carrying amount is charged or credited to the income statement, any amounts included in revaluation reserves that originated when investment properties were transferred from property, plant and equipment are transferred to retained earnings.

1.11 PROPERTY, PLANT AND EQUIPMENT

Land is stated at its original cost price and is not depreciated.

Other property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Directly attributable costs associated with the acquisition, development and installation of certain software are capitalised.

Depreciation is provided for on a straight-line basis over the expected useful lives of the property, plant and equipment. Useful life is either the period of time over which the asset is expected to be used or the production expected to be obtained from the asset. Lease improvement on leasehold property is depreciated over the period of the lease or the useful life whichever is the shorter period. Where a permanent impairment between the carrying amounts and the recoverable values of a category of property, plant and equipment occurs, the carrying amounts are adjusted and the impairment losses charged to the income statement. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present values using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Acquisitions with a cost price of less than R2 000 are charged against operating profit. The estimated useful lives are as follows:

• Buildings and infrastructure	between 20 and 50 years
• Plant	between 5 and 10 years
• Machinery and equipment	between 5 and 10 years
• Vehicles	5 years
• Office furniture and accessories	between 3 and 10 years
• Computer equipment	between 3 and 5 years
• Computer software	2 years

Properties that need to be transferred to investment property due to the change in the use of the property are revalued to fair value prior to such transfer and the surplus on revaluation is credited to a revaluation reserve.

1.12 INTANGIBLE ASSETS

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment.

• Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of net assets of the acquired subsidiary at the date of acquisition. Goodwill is amortised using the straight-line method over a period of 20 years. In the case of a permanent impairment in the value of the goodwill, it is written off to the income statement.

• Research and development costs

Research and development costs are recognised as expenses except costs incurred on qualifying development projects. Such costs are recognised as development assets (intangible assets). However, development costs initially recognised as an expense are not recognised as an asset in a subsequent period.

Development costs are capitalised where contracts and markets for a specific product already exist, or where there is reasonable certainty that contracts, will result in a return on the development costs. The amortisation of capitalised development costs commences once the product or service becomes available for sale or use. Costs are amortised over the period of expected economic benefit to a maximum of five years.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, and otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

• Patents

Patents assets are recognised at cost if it is probable that future economic benefits will flow to the Group. Amortisation is charged on a systematic basis over the estimated useful lives of the patents, which are determined by their legal rights but do not exceed 20 years.

1.13 INVENTORIES

Inventories are stated on the first-in-first-out (FIFO) basis at the lower of cost price and net realisable value. Net realisable value is the estimate of the selling price in the ordinary course of business less the cost of completion and selling expenses. The weighted average basis is used for certain inventory items such as chemicals and liquids where it is not practical to apply the FIFO basis.

The following specific methods are applied in determining cost price:

- **Raw materials and bought-out components**

These are valued at direct cost of purchase plus the carrying costs of that purchase.

- **Work in progress, finished products and contracts in progress**

These are valued at cost and include the cost of purchase of direct materials, direct labour, allocated variable and fixed production overheads based on normal production levels.

- **Consumable inventories**

Consumable inventories are valued at the direct cost of purchase.

- **Property development**

Property development is valued at cost and includes directly attributable transaction costs, costs of purchases of property, development costs, construction costs and borrowing costs.

1.14 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise of cash on hand, deposits on call with banks, and investments in money market instruments with an original maturity of three months or less.

Bank overdrafts are treated as part of short-term funding and are included in borrowings in current liabilities.

1.15 CAPITALISATION OF BORROWING COSTS

Borrowing costs incurred on qualifying assets are capitalised up to the date that the assets are substantially complete. Capitalisation is suspended during extended periods in which active development is interrupted. Qualifying assets are those that necessarily take a substantial period of time to prepare for their intended use or sale.

1.16 ADVANCE PAYMENTS RECEIVED FROM SALES CONTRACTS

In the case of comprehensive and/or long-term sales contracts, advance payments are negotiated with local and foreign clients. These funds are used to finance the execution of the contracts which include advance payments made to suppliers, long-lead inventory items and work in progress. Guarantees are provided to clients from whom advance payments have been received. The financing benefit, which results from advance payments that have been received, is included in the gross revenue. Advance payments received are recognised as a current liability. Advance payments received in foreign currency are recognised at the ruling spot rate on the date of receipt.

1.17 RETIREMENT BENEFITS

- **Pension obligations**

The Group operates a defined benefit and a defined contribution plan, the assets of which are held in separate trustee administered funds. The pension plans are funded by payments from employees and by the relevant Group companies, taking account of the recommendations of independent qualified actuaries.

For defined benefit plans, the pension accounting costs are assessed using the projected unit credit method. Under this method, the cost of providing pensions is charged to the income statement to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries who carry out a full valuation of the plan every three years. The pension obligations are measured as the present value of the estimated future cash outflows using interest rates of government securities that have terms of maturity approximating the terms of the related liability.

All actuarial gains and losses are spread forward over the average remaining service lives of employees.

The Group's contributions to the defined contribution pension plans are charged to the income statement in the year to which they relate.

- **Other post-retirement obligations**

The Group provides post-retirement medical aid contribution subsidies to qualifying retirees. The expected cost of this benefit is accrued over the period of employment and is funded in the Denel Medical Benefit Trust. Independent qualified actuaries on a yearly basis carry out valuation of these obligations.

1.18 COUNTER TRADE OBLIGATIONS

Counter trade obligations arise when the Group enters into export sale contracts where the buyer's country requires counter trade to be performed by the seller. These counter trade obligations can be a percentage of the value of the export sales contract up to hundred percent. The buyer's country normally requires a combination of the following to discharge the counter trade obligation: procurement of products and services from suppliers in the buyer's country; participating in a business venture in the buyer's country or prescribing a form of investment in the buyer's country.

Measurement and recognition of provisions, expenses and contingent liabilities, related to counter trade obligations are accounted for in accordance with Statements of Generally Accepted Accounting Practice in line with the Group's accounting policies.

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		2. REVENUE		
4 321,0	4 292,4	Sales	**4 057,5**	3 948,8
77,6	35,8	Rental on investment properties	**40,5**	0,9
43,6	44,2	Interest income on advance contract payments	**43,6**	44,2
4 442,2	4 372,4		**4 141,6**	3 993,9
		3. OPERATING EXPENSES AND COST OF SALES		
		By nature		
1 442,7	1 649,9	Materials	**1 527,2**	1 671,2
54,7	63,6	Consumables	**51,4**	59,6
1 901,6	1 713,3	Staff costs	**1 617,4**	1 456,3
214,0	186,1	Research and development costs	**213,6**	181,6
121,0	107,2	Depreciation	**102,3**	83,1
611,5	431,2	Other expenses and charges	**514,0**	299,8
(36,4)	63,1	Movement in inventories	**(54,9)**	31,5
4 309,1	4 214,4		**3 971,0**	3 783,1
		By function		
3 154,9	3 096,1	Cost of sales	**2 977,5**	2 820,5
1 154,2	1 118,3	Operating expenses	**993,5**	962,6
4 309,1	4 214,4		**3 971,0**	3 783,1
		The following items have been taken into account in arriving at operating profit before borrowing costs:		
8,0	5,1	**License fees**	**8,0**	5,0
2,1	7,4	**Administrative fees paid – external**	**0,3**	2,3
0,7	2,1	**Amortisation of intangible assets**	**0,2**	0,3
0,1	1,2	Development costs	**–**	0,3
0,4	0,9	Goodwill	**–**	–
0,2	–	Patents	**0,2**	–
9,9	11,6	**Auditors' remuneration**	**8,6**	10,3
9,3	8,2	Current year	**8,0**	7,0
0,2	(0,1)	Previous year under/(over) provision	**0,2**	(0,1)
0,4	3,5	Other services	**0,4**	3,4
214,0	186,1	**Research and development costs**	**213,6**	181,6
2,3	1,4	Research expenses	**2,3**	0,5
211,6	183,5	Development expenses	**211,3**	180,8
0,1	1,2	Amortisation of capitalised development costs	**–**	0,3
64,7	–	Impairment of capitalised development cost	**64,7**	–
(64,7)	–	*Less:* Separately disclosed	**(64,7)**	–

3. OPERATING EXPENSES AND COST OF SALES (continued)

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
121,0	107,2	**Depreciation**	**102,3**	83,1
14,7	11,7	Buildings	**13,0**	9,5
75,2	64,6	Plant and machinery	**63,4**	46,3
7,7	6,9	Vehicles and office furniture	**6,2**	5,4
23,4	24,0	Computer equipment	**19,7**	21,9
2,0	(2,3)	**Loss/(profit) on disposal of property, plant and equipment**	**2,0**	(2,0)
(2,6)	(1,8)	**Profit on disposal of investment properties**	**–**	–
83,9	62,7	**Repairs and maintenance**	**71,9**	59,1
7,3	10,8	**Directors' remuneration**	**7,3**	10,8
6,3	9,7	Executive directors	**6,3**	9,7
3,2	3,7	Remuneration	**3,2**	3,7
0,6	0,7	Allowances	**0,6**	0,7
2,0	4,8	Loss of office	**2,0**	4,8
0,5	0,5	Contributions made: pension and medical	**0,5**	0,5
1,0	1,1	Non-executive directors	**1,0**	1,1
1,0	1,1	For services as directors	**1,0**	1,1
		Remuneration per director is fully detailed in the Directors' report.		
1 901,6	1 713,3	**Staff costs**	**1 617,4**	1 456,3
1 620,6	1 490,3	Services costs	**1 366,7**	1 254,6
123,7	130,7	Staff and related provisions	**106,8**	117,3
100,9	93,0	Medical fund contributions	**95,8**	89,3
20,6	(5,0)	Termination benefits paid	**17,3**	(5,2)
87,5	79,5	Pension costs – defined contribution plan	**82,5**	75,5
1,1	1,2	Pension costs – defined benefit plan	**1,1**	1,2
(52,8)	(76,4)	Contribution holiday	**(52,8)**	(76,4)
Number	Number		**Number**	Number
10 925	10 878	Average number of persons employed by the group during the year	**10 150**	10 188
6 597	6 504	Full time (permanent contracts)	**6 233**	6 216
4 328	4 374	Part time and alternative contract workers	**3 917**	3 972
R millions	R millions		**R millions**	R millions
		Income from subsidiaries	**38,2**	45,9
		Rent	**0,1**	0,4
		Interest	**36,6**	37,9
		Administration fees	**1,5**	7,6
46,2	37,3	**Operating lease rentals**	**35,1**	29,1
20,2	17,9	Buildings	**11,9**	11,5
4,0	6,1	Plant and machinery	**2,6**	5,0
13,9	6,5	Vehicles and office furniture	**12,7**	5,8
8,1	6,8	Computer equipment	**7,9**	6,8

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		3. OPERATING EXPENSES AND COST OF SALES (continued)		
283,6	293,5	**Provisions**	**247,2**	264,4
84,1	60,0	Contracts risks	**68,4**	45,1
78,4	99,6	Product warranty	**77,9**	99,2
4,3	(1,9)	Product recall	**4,3**	(1,9)
144,3	123,6	Staff and related	**124,1**	109,8
311,1	281,3		**274,7**	252,2
(27,5)	12,2	*Less:* Separately disclosed	**(27,5)**	12,2
(4,3)	1,9	– product recall	**(4,3)**	1,9
(0,3)	–	– discontinuing operations	**(0,3)**	–
(22,9)	10,3	– retrenchment costs	**(22,9)**	10,3
		4. NET FINANCE CHARGES		
		Intragroup	**(19,7)**	(24,4)
		Interest received	**(36,6)**	(37,9)
		Interest paid	**16,9**	13,5
127,1	107,8	**External**	**137,2**	117,8
120,0	109,0	Interest paid	**118,4**	106,5
10,5	39,0	Current borrowings	**9,2**	36,6
		Non-current borrowings		
3,3	3,8	– Secured	**3,0**	3,7
106,2	66,2	– Unsecured	**106,2**	66,2
(28,4)	(38,7)	Interests received	**(20,4)**	(28,6)
(26,4)	(38,7)	Gross interest received	**(18,4)**	(28,6)
(0,6)	–	Fair value adjustment	**(0,6)**	–
(1,4)	–	Market interest adjustment	**(1,4)**	–
91,6	70,3	Net interest paid	**98,0**	77,9
43,6	44,2	Interest received on advance contract payments	**43,6**	44,2
(4,4)	(4,3)	Capitalised to property, plant and equipment	**(4,4)**	(4,3)
(3,7)	(2,4)	Capitalised to property development	**–**	–
127,1	107,8	**Net interest paid**	**117,5**	93,4
		5. FOREIGN EXCHANGE LOSS		
97,9	203,8	Losses on settled transactions	**92,8**	203,1
(294,0)	(120,0)	Gains on settled transactions	**(293,2)**	(113,1)
629,5	113,4	Losses on revaluation	**629,4**	111,3
(178,9)	(45,3)	Gains on revaluation	**(178,6)**	(45,4)
254,5	151,9	Net foreign exchange loss	**250,4**	155,9

6. DISCONTINUING OPERATIONS

During the previous year the process to exit the commercial aircraft business at the Datam division of Denel due to the decline in the business was completed. The unused provision on closure that was reversed during the year amounts to R0,7 million.

The disposal of the Airmotive Division to Turbomeca Africa (Pty) Limited was also completed during the previous year. A new company, Turbomeca Africa (Pty) Limited, was formed. Denel has 49% stake in the company. The equity method was used for the consolidation of Denel's interest. The transaction was part of the restructuring of Denel. The effective date of the transaction was 2 August 2002. The final settlement of the remuneration was disputed and resolved during the current year which resulted in an additional loss of R1,0 million that reduced the loan account of the associated company.

GROUP R millions			COMPANY R millions	
2004	2003		**2004**	2003
		The results are as follows:		
–	209,2	Revenue	–	95,1
–	(194,5)	Costs of sales	–	(79,9)
–	14,7	Gross profit	–	15,2
–	(35,8)	Operating costs	–	(36,0)
–	(21,1)	Loss on ordinary activities	–	(20,8)
–	(7,6)	Net finance costs	–	(13,8)
–	(28,7)	Loss before taxation	–	(34,6)
–	–	Taxation	–	–
–	(28,7)	Loss after taxation	–	(34,6)
–	(82,2)	Cash flow from operating activities	–	(31,4)
–	6,3	Cash flow from investment activities	–	(8,2)
–	39,6	Cash flow from financing activities	–	39,6
		The proceeds on the sale was as follows		
–	151,1	Net asset value	–	151,1
–	(48,1)	Loss of sale of business	–	(48,1)
–	103,0	Selling price	–	103,0
–	(28,8)	*Less:* Shares received	–	(28,8)
–	(44,2)	*Less:* Loans received	–	(44,2)
–	30,0	Net cash flow on disposal	–	30,0
		Loss on discontinuing operations		
–	(48,1)	Loss on disposal	–	(48,1)
(0,3)	(41,3)	Amounts written off due to discontinuation	**(0,3)**	(41,3)
(0,3)	(89,4)	Loss on discontinuation	**(0,3)**	(89,4)
–	100,8	Provision applied	–	100,8
(0,3)	11,4	Net (loss)/profit on discontinuation	**(0,3)**	11,4
		The assets and liabilities disposed of were as follows:		
–	52,2	Non-current assets	–	52,2
–	153,3	Current assets	–	153,3
–	205,5	Total assets	–	205,5
–	(54,4)	Total liabilities	–	(54,4)
–	151,1	Net assets	–	151,1

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		7. TAXATION		
25,9	10,1	**SA normal taxation**	**–**	–
17,3	11,2	Current tax	**–**	–
0,6	–	Deferred taxation (refer to note 15)	**–**	–
8,0	(1,1)	Share of tax of associates	**–**	–
0,7	0,1	**Secondary tax on companies**	**–**	–
		Foreign taxation		
0,2	18,4	Withholding tax on dividend	**0,2**	18,4
26,8	28,6		**0,2**	18,4
		No provision for SA normal taxation has been made for the Company, as the Company has an assessed loss.		
%	%	**Reconciliation (%)**	**%**	%
(7,5)	(65,6)	Effective rate of taxation	**–**	9,5
37,5	95,6	Reduction/(increase) in rate of taxation due to:	**30,0**	20,5
0,3	38,9	Exempt income	**0,3**	(8,7)
–	1,2	Capital profits	**–**	–
(6,6)	(94,6)	Non-recognition of deferred tax asset	**(6,7)**	21,4
0,2	1,5	Non-taxable capital gain on property, plant and equipment	**–**	(0,1)
–	(0,2)	Capital gain taxable	**–**	–
–	42,4	Withholding tax on dividend	**–**	(9,5)
(13,9)	(155,7)	Other	**(11,3)**	34,8
57,5	262,1	Assessed loss carried forward	**47,7**	(17,4)
30,0	30,0	SA normal taxation rate	**30,0**	30,0
R millions	R millions	**Assessed losses**	**R millions**	R millions
		The estimated assessed losses available for set-off against future taxable income are as follows:		
1 581,5	1 290,6	Total available assessed losses	**1 132,4**	918,8
0,7	0,5	Capital gains assessed loss	**0,3**	0,4
1 582,2	1 291,1	Net available assessed losses after application to reduce deferred taxation	**1 132,7**	919,2

8. EARNINGS PER SHARE/HEADLINE EARNINGS PER SHARE

The calculation of earnings per share for the Group is based on a loss of R377,5 million (2003: R72,6 million) and 442 109 596 Class A and Class B ordinary shares issued (2003: 442 109 596)

The calculation of headline earnings per share for the Group is based on a loss of R336,6 million (2003: R39,7 million) and 442 109 596 Class A and Class B ordinary shares issued (2003: 442 109 596). There is no tax effect due to the assessed loss.

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		8. EARNINGS PER SHARE/HEADLINE EARNINGS PER SHARE (continued)		
		Reconciliation between earnings and headline earnings		
(377,5)	(72,6)	Net loss		
40,9	32,9	Adjustments:		
0,3	(11,4)	Loss/(profit) on discontinuing operations		
–	15,7	Goodwill impaired		
0,4	0,9	Goodwill amortised		
38,2	30,0	Property, plant and equipment impaired		
2,0	(2,3)	Loss/(profit) on disposal of property, plant and equipment		
(336,6)	(39,7)	Headline earnings		

	Land and buildings R millions	Plant and machinery R millions	Vehicles and office furniture R millions	Computer equipment R millions	Total R millions
9. PROPERTY, PLANT AND EQUIPMENT					
Carrying amount					
Group: 2004					
Carrying amount at 1 April 2003	**276,2**	**364,8**	**18,7**	**50,1**	**709,8**
Acquisitions	**28,2**	**89,7**	**11,2**	**19,2**	**148,3**
Disposals	**(1,8)**	**(0,6)**	**(0,1)**	**–**	**(2,5)**
Transfer to investment properties	**0,2**	**–**	**–**	**–**	**0,2**
Reclassification – transfer to intangible assets	**–**	**(1,3)**	**–**	**–**	**(1,3)**
Impairment	**(2,6)**	**(35,6)**	**–**	**–**	**(38,2)**
Depreciation for the year	**(14,7)**	**(75,2)**	**(7,7)**	**(23,4)**	**(121,0)**
Carrying amount at 31 March 2004	**285,5**	**341,8**	**22,1**	**45,9**	**695,3**
Cost or valuation	**521,4**	**1 463,2**	**83,8**	**146,8**	**2 215,2**
Accumulated depreciation	**235,9**	**1 121,4**	**61,7**	**100,9**	**1 519,9**
Carrying amount	**285,5**	**341,8**	**22,1**	**45,9**	**695,3**
Group: 2003					
Carrying amount at 1 April 2002	316,8	366,6	25,8	49,1	758,3
Acquisitions	8,4	141,6	5,8	26,1	181,9
Disposals	(1,3)	(1,8)	(0,1)	(0,1)	(3,3)
Disposed as part of business	–	(51,3)	(0,4)	(1,0)	(52,7)
Transfer to investment properties	(80,5)	–	–	–	(80,5)
Revaluation	43,3	–	–	–	43,3
Reclassification	8,7	(3,2)	(5,5)	–	–
Impairment	(7,5)	(22,5)	–	–	(30,0)
Depreciation for the year	(11,7)	(64,6)	(6,9)	(24,0)	(107,2)
Carrying amount at 31 March 2003	276,2	364,8	18,7	50,1	709,8
Cost or valuation	497,1	1 394,8	73,7	136,2	2 101,8
Accumulated depreciation	220,9	1 030,0	55,0	86,1	1 392,0
Carrying amount	276,2	364,8	18,7	50,1	709,8

	Land and buildings R millions	Plant and machinery R millions	Vehicles and office furniture R millions	Computer equipment R millions	Total R millions
9. PROPERTY, PLANT AND EQUIPMENT (continued)					
Company: 2004					
Carrying amount at 1 April 2003	**249,4**	**258,3**	**14,7**	**46,5**	**568,9**
Acquisitions	**28,4**	**88,3**	**7,6**	**18,0**	**142,3**
Disposals	**(2,0)**	**(0,7)**	**(0,2)**	**(1,2)**	**(4,1)**
Transfer to investment properties	**0,2**	**–**	**–**	**–**	**0,2**
Reclassification – transfer to intangible assets	**–**	**(1,3)**	**–**	**–**	**(1,3)**
Impairment	**–**	**(25,7)**	**–**	**–**	**(25,7)**
Depreciation for the year	**(13,0)**	**(63,4)**	**(6,2)**	**(19,7)**	**(102,3)**
Carrying amount at 31 March 2004	**263,0**	**255,5**	**15,9**	**43,6**	**578,0**
Cost or valuation	**483,4**	**1 289,8**	**70,4**	**127,1**	**1 970,7**
Accumulated depreciation	**220,4**	**1 034,3**	**54,5**	**83,5**	**1 392,7**
Carrying amount	**263,0**	**255,5**	**15,9**	**43,6**	**578,0**
Company: 2003					
Carrying amount at 1 April 2002	282,3	214,9	15,9	47,0	560,1
Acquisitions	8,3	130,7	4,5	22,2	165,7
Disposals	(1,3)	(1,8)	(0,3)	(0,1)	(3,5)
Disposed as part of business	–	(36,9)	–	(0,7)	(37,6)
Transfer to investment properties	(76,0)	–	–	–	(76,0)
Revaluation	43,3	–	–	–	43,3
Reclassification	2,3	(2,3)	–	–	–
Depreciation for the year	(9,5)	(46,3)	(5,4)	(21,9)	(83,1)
Carrying amount at 31 March 2003	249,4	258,3	14,7	46,5	568,9
Cost or valuation	459,0	1 216,1	64,5	121,8	1 861,4
Accumulated depreciation	209,6	957,8	49,8	75,3	1 292,5
Carrying amount	249,4	258,3	14,7	46,5	568,9

A register of fixed properties is kept and is open for inspection at the registered office of the Company by the members or their duly authorised representatives.

Due to the continued losses at Denel Aviation, the related plant and machinery was impaired by R25,7 million. The recoverable amount was based on the value in use and a 16% discount rate was used.

Due to the continued losses at SPP (Pty) Limited, the related property, plant and machinery was impaired by R12,5 million. The recoverable amount was based on the net selling price that represents an offer received to buy the company.

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		10. INVESTMENT PROPERTIES		
301,8	215,4	Market value at 31 March 2003	**76,1**	–
13,2	13,5	Additions at cost	**–**	–
(0,2)	80,5	Transfer from property, plant and equipment	**(0,2)**	76,1
22,0	6,1	Fair value adjustment	**23,8**	–
(5,4)	(13,7)	Disposals	**–**	–
331,4	301,8	Market value at 31 March 2004	**99,7**	76,1

Investment properties were revalued at year-end by an external registered appraiser, except for those where it is difficult to determine a value due to the remote location and/or the specialised nature. The carrying value of properties that are not recognised at fair value is R8,5 million for the group and R4,2 million for the Company.

Certain investment properties to the value of R30 million (2003: R30 million) serve as security for borrowings of R12,2 million (2003: R19,3 million) (refer to note 22).

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		11. INTANGIBLE ASSETS		
		Carrying amount		
26,3	65,2	*Development costs*	**26,2**	65,2
26,4	66,4	Total costs	**26,2**	65,4
(0,1)	(1,2)	*Less:* Accumulated amortisation	**–**	(0,2)
–	0,4	*Goodwill*	**–**	–
17,9	19,8	At acquisition (including charges)	**–**	–
–	(1,9)	*Less:* Goodwill in respect of subsidiaries disposed	**–**	–
(15,7)	(15,7)	Impairment	**–**	–
(2,2)	(1,8)	Cumulative amortisation	**–**	–
1,1	–	*Patents*	**1,1**	–
8,9	–	At acquisition (including charges)	**2,4**	–
(7,8)	–	Cumulative amortisation	**(1,3)**	–
27,4	65,6	**Total carrying amount**	**27,3**	65,2

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		11. INTANGIBLE ASSETS (continued)		
		Reconciliation		
		Development costs		
65,2	40,4	Carrying value as at 1 April 2003	**65,2**	23,6
25,9	41,9	Capitalised during the year	**25,7**	41,9
–	(15,9)	Disposed during the year	**–**	–
(64,7)	–	Impairment	**(64,7)**	–
(0,1)	(1,2)	Charged to income statement	**–**	(0,3)
26,3	65,2	Carrying amount 31 March 2004	**26,2**	65,2
		Included in the development costs is an amount of R26,2 million (2003: R65,2 million) for which amortisation has not commenced.		
		Goodwill		
0,4	18,9	Carrying value as at 1 April 2003	**–**	–
–	(1,9)	Goodwill of subsidiaries disposed	**–**	–
–	(15,7)	Goodwill impaired	**–**	–
(0,4)	(0,9)	Amortisation for the year	**–**	–
–	0,4	Carrying amount 31 March 2004	**–**	–
		Patents		
–	–	Carrying value as at 1 April 2003	**–**	–
1,3	–	Reclassification – transfer from property, plant and equipment	**1,3**	–
(0,2)	–	Amortisation for the year	**(0,2)**	–
1,1	–	Carrying amount 31 March 2004	**1,1**	–
		The remaining useful life of the patents is 5 years.		
27,4	65,6	**Total carrying amount**	**27,3**	65,2
		12. INVESTMENT IN SUBSIDIARIES		
		Unlisted shares	**144,3**	144,3
		Loans	**174,3**	207,3
		Total investment in subsidiaries net of impairment	**318,6**	351,6
		The impairment loss on investment in subsidiaries is as follows:		
		Unlisted shares	**12,0**	12,0
		Loans	**400,6**	293,2
			412,6	305,2
		Detail breakdown of the investments in subsidiaries is on page 96. R477,2 million of the loans to subsidiaries has been subordinated in favour of the creditors of the subsidiaries.		

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		13. ASSOCIATED COMPANIES		
214,0	205,3	Unlisted shares	**197,6**	217,7
20,6	25,5	Loans	**–**	21,6
(24,0)	22,2	Net share of results of associates	**–**	–
210,6	253,0	**Total investment in associates net of impairment**	**197,6**	239,3
		Reconciliation of investment in associated companies		
234,6	230,8	Cost less amounts written off		
(24,0)	22,2	Share of (accumulated loss)/retained profit		
(38,2)	12,9	(Loss)/profit before tax		
(8,0)	1,1	Taxation		
(46,2)	14,0	(Loss)/profit after tax		
22,2	8,2	Retained earnings at beginning of the year		
210,6	253,0	Total carrying value		
		The impairment loss on investment in associated companies is as follows:		
–	–	Unlisted shares	**28,8**	–
11,7	–	Loans	**20,6**	–
11,7	–		**49,4**	–
		The directors are of the opinion that the carrying value of the associates is fairly stated.		
		The following represents the aggregate of the Group's portion of its associates:		
103,2	92,2	Non-current assets		
252,3	192,5	Current assets		
37,9	34,2	Non-current liabilities		
229,7	125,9	Current liabilities		
519,0	391,5	Revenue		
46,2	14,0	Profit after tax		
		Detail breakdown of the investments in associates is on page 96.		
		14. OTHER INVESTMENTS		
41,7	47,4	Loans at cost	**41,7**	46,9
(2,3)	–	Fair value adjustment	**(2,3)**	–
1,4	–	Market interest adjustment	**1,4**	–
40,8	47,4		**40,8**	46,9
(3,9)	(5,5)	*Less:* payable within next 12 months (refer to note 17)	**(3,9)**	(5,3)
36,9	41,9		**36,9**	41,6

As part of the adoption of AC133, a fair value adjustment has been made for the current year (refer to note 4 and 30). Interest is earned at a fixed rate of 9% per annum. The loan is repayable in monthly instalments with the last instalment payable on 31 March 2012.

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		15. DEFERRED TAXES		
48,0	42,7	Deferred tax assets	**18,2**	12,3
(48,6)	(42,7)	Deferred tax liabilities	**(18,2)**	(12,3)
(0,6)	–		**–**	–
		Movement of deferred tax assets and liabilities:		
–	–	Balance at the beginning of the year	**–**	–
(0,6)	–	Per income statement	**–**	–
(0,6)	–		**–**	–
		Net deferred tax asset (liability) comprises:		
(27,3)	(29,0)	Capital allowances	**–**	(1,6)
5,8	5,2	Provisions	**–**	–
1,0	1,7	Prepayments received	**–**	–
(2,1)	(0,6)	Prepayments made	**–**	–
(18,9)	(11,7)	Other taxable differences	**(18,2)**	(10,7)
18,2	12,3	Other deductible differences	**18,2**	12,3
22,7	22,1	Assessed loss	**–**	–
(0,6)	–		**–**	–

For certain companies in the Group no deferred tax asset has been recognised relating to assessed losses and deductible temporary differences due to the uncertainty of the timing and the amount that could be recovered against future taxable income.

Had a deferred tax asset been recognised the value of the asset at year-end would have been R917,8 million (2003: R767,4 million) for the Group and R806,0 million (2003: R680,5 million) for the Company.

In the previous year deferred tax assets and liabilities were disclosed on a net basis. To enhance disclosure and ensure compliance with AC102: Income taxes, the comparatives have been adjusted to disclose deferred tax assets and liabilities on an individual basis.

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		16. INVENTORIES		
		At lower of cost or net realisable value		
284,2	239,8	Raw materials and components	**273,0**	223,6
177,9	253,0	Work in progress	**175,2**	247,2
501,4	462,7	Contracts in progress	**501,4**	462,7
40,5	56,9	Property development	**–**	–
267,7	230,9	Finished goods	**254,1**	221,7
50,4	42,4	Consumables	**45,3**	38,9
1 322,1	1 285,7	**Total inventories**	**1 249,0**	1 194,1
321,7	288,3	Impairment set off against inventory	**303,9**	286,8

The impairment comprises of slow moving, obsolete and redundant inventories.

Borrowing costs of R3,7 million (2003: R2,3 million) arising on financing specifically entered into for property development were capitalised during the year and are included in property developments.

A capitalisation rate of 11,6% (2003: 12,5%) was used representing the actual borrowing cost of the loan used to finance the project.

The separate disclosed amounts of R15,5 million for the impairment of inventories and R6,7 million for contract risk relates to a specific project at one of the subsidiaries that was cancelled for which a firm purchase order exists.

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		17. RECEIVABLES AND PREPAYMENTS MADE		
–	–	**Non-current**	–	–
11,9	15,5	Contract customers	**11,9**	15,5
(11,9)	(15,5)	*Less:* Payable within 12 months	**(11,9)**	(15,5)
903,7	1 061,0	**Current**	**781,7**	953,0
710,9	837,9	Trade receivables	**618,9**	744,9
–	–	Trade receivables – intergroup	**0,7**	10,6
11,9	15,5	Contract customers	**11,9**	15,5
1,1	1,8	Interest accrued	**0,4**	0,7
101,3	54,3	Prepayments and advances made	**94,2**	54,6
3,9	5,5	Current portion of other investment (refer to note 14)	**3,9**	5,3
8,5	47,7	Other financial assets	**5,1**	37,7
66,1	98,3	Other receivables	**46,6**	83,7
903,7	1 061,0	**Total accounts receivables**	**781,7**	953,0
46,7	98,3	Impairment set off against trade receivables	**31,5**	89,3

Other financial assets comprise mainly of short-term bridging finance to associates, which are repaid within 30 days and interest is charged at market related rates linked to the prime rate.

Specific impairments are made for identified doubtful debts. No portfolio impairment was considered necessary as the receivables mainly comprise of the South African Government and foreign governments, and the credit risk is covered by credit insurance and/or irrevocable confirmed letter of credit.

GROUP 2004	GROUP 2003		COMPANY 2004	COMPANY 2003
		18. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES		
		18.1 Derivative financial assets		
125,7	49,9	Foreign exchange contracts	**125,7**	49,9
74,7	–	Foreign exchange options	**74,7**	–
21,4	–	Foreign exchange embedded derivatives	**21,4**	–
221,8	49,9		**221,8**	49,9
		18.2 Derivative financial liabilities		
98,9	4,2	Foreign exchange contracts	**98,9**	4,2
–	–	Foreign exchange options	–	–
362,9	–	Foreign exchange embedded derivatives	**362,9**	–
461,8	4,2		**461,8**	4,2

GROUP R millions 2004	GROUP R millions 2003		COMPANY R millions 2004	COMPANY R millions 2003
		19. CASH AND CASH EQUIVALENTS		
		Deposits		
207,0	286,7	Call deposits	**160,0**	235,0
207,0	286,7	Local	**160,0**	235,0
83,9	151,1	**Cash in bank**	**71,0**	142,3
53,4	38,9	Local banks	**40,7**	32,8
30,5	112,2	Foreign banks	**30,3**	109,5
3,8	4,8	**Cash on hand**	**0,3**	0,3
294,7	442,6	**Total cash and cash equivalents**	**231,3**	377,6
		The weighted average effective interest rate on call deposits was 11,97% (2003: call deposits 11,74% and fixed deposits 12,02%). Interest on cash in bank is earned at market rates. The funds included in cash and cash equivalents are available on demand.		
		Undrawn borrowing facilities		
449,3	514,8	General banking facilities	**449,3**	514,8
		The general banking facilities are unsecured, bears interest at a rate linked to prime, have no specific maturity date and are subject to annual review. The facilities are in place to ensure liquidity.		
		20. SHARE CAPITAL		
		Authorised		
1 000,0	1 000,0	1 000 000 000 Class A ordinary shares of R1 each	**1 000,0**	1 000,0
232,5	232,5	232 455 747 Class B ordinary shares of R1 each	**232,5**	232,5
1 232,5	1 232,5	**Total authorised share capital**	**1 232,5**	1 232,5
		Issued		
		Shares at par value		
401,9	401,9	401 873 849 Class A ordinary shares of R1 each	**401,9**	401,9
40,3	40,3	40 235 747 Class B ordinary shares of R1 each	**40,3**	40,3
442,2	442,2	Ordinary share capital	**442,2**	442,2
1 534,2	1 534,2	*Share premium*	**1 534,2**	1 534,2
1 976,4	1 976,4	**Total issued share capital**	**1 976,4**	1 976,4
		No shares were issued during the financial years reported. The unissued share capital is under the control of the South African Government being the sole shareholder.		

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		21. MINORITY INTEREST		
20,0	18,1	At beginning of year		
(6,9)	0,4	Share of net (loss)/profit of subsidiaries		
–	1,5	Change due to disposal of subsidiary		
(3,9)	–	Minorities share in dividend		
9,2	20,0	At end of year		
		22. BORROWINGS		
832,1	840,9	**Non-current**	**829,8**	837,3
11,0	21,2	*Local secured loan*	**8,7**	17,6
20,3	29,8	Local secured loan	**16,6**	24,7
(9,3)	(8,6)	*Less:* Payable within the next year	**(7,9)**	(7,1)
821,1	819,7	*Local unsecured loan*	**821,1**	819,7
821,1	819,7	Local unsecured loan	**821,1**	819,7
75,7	8,7	**Current**	**74,3**	7,1
–	0,1	Bank overdraft	**–**	–
9,3	8,6	Current portion of non-current borrowings	**7,9**	7,1
66,4	–	Bank borrowings (drawn general banking facilities)	**66,4**	–
907,8	849,6	**Total borrowings**	**904,1**	844,4

Borrowings of R12,2 million (2003: R19,3 million) are secured by certain of the investment properties (refer to note 10).

Repayments of the local secured loan is in equal monthly instalments. Once-off repayment of the local unsecured loan will be done on 16 August 2007. Interest is paid bi-annually.

GROUP 2004	2003			COMPANY 2004	2003
		Weighted average effective interest rates			
10,99	10,99	Local secured loan (fixed rate) (%)		**10,99**	10,99
12,83	12,83	Local unsecured loan (fixed rate) (%)		**12,83**	12,83
9,46	13,02	Short-term bank borrowings (floating rate) (%)		**9,46**	13,02
		Summary interest-bearing borrowings:	**Rate (%)**		
–	8,7	Maturing by 31 March 2004	10,85	**–**	7,1
75,7	16,9	Maturing by 31 March 2005	10,99	**74,3**	13,3
11,0	4,3	Maturing by 31 March 2006	10,99	**8,7**	4,3
821,1	819,7	Maturing by 31 March 2008	12,83	**821,1**	819,7
907,8	849,6	**Total**		**904,1**	844,4

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		23. PROVISIONS		
20,7	22,1	**Non-current provisions**	**18,5**	20,1
2,2	2,0	Contracts risks	**–**	–
18,5	20,1	Product warranty	**18,5**	20,1
437,9	436,0	**Current provisions**	**400,0**	409,5
120,4	127,4	Contracts risks	**96,8**	111,1
132,3	130,0	Product warranty	**131,5**	129,6
6,9	8,7	Product recall	**6,9**	8,7
178,3	169,9	Staff and related	**164,8**	160,1
458,6	458,1	**Total provisions**	**418,5**	429,6

RECONCILIATION

	Contracts risks	Product warranty	Product recall	Staff and related	Total
Group					
Opening balance	129,4	150,1	8,7	169,9	458,1
Realised	(90,9)	(77,7)	(6,1)	(135,9)	(310,6)
Unused amounts reversed	(13,7)	(1,2)	(2,6)	(15,6)	(33,1)
Charged to the income statement	97,8	79,6	6,9	159,9	344,2
Closing balance	122,6	150,8	6,9	178,3	458,6
Company					
Opening balance	111,1	149,7	8,7	160,1	429,6
Realised	(82,7)	(77,6)	(6,1)	(119,4)	(285,8)
Unused amounts reversed	(13,7)	(1,0)	(2,6)	(15,3)	(32,6)
Charged to the income statement	82,1	78,9	6,9	139,4	307,3
Closing balance	96,8	150,0	6,9	164,8	418,5

Contract risks
The provision for contract risks comprises all potential losses on contracts that the Group has entered into.

Product warranty
The provision for product warranty comprises all legal and constructive obligations of the Group related to products delivered.

Product recall
The provision for product recall comprises the estimated cost that the Group will incur in the process of a specific product recall.

Staff and related
This provision comprises the estimated cost for accumulated leave, guaranteed thirteenth cheque, retrenchment costs and performance bonus.

GROUP R millions 2004	2003		COMPANY R millions 2004	2003
		24. TRADE PAYABLES AND OTHER PAYABLES		
483,6	543,0	Trade payables	**451,4**	506,8
14,3	13,7	Interest accrued	**14,2**	13,7
94,5	101,2	Other accruals	**72,2**	74,5
–	–	Intergroup payables	**11,7**	18,7
592,4	657,9	**Total payables**	**549,5**	613,7
		25. CAPITAL COMMITMENTS		
		Capital commitments authorised by the Board.		
33,6	26,1	Approved and contracted for	**33,6**	26,1
1,0	8,6	Approved but not contracted for	**1,0**	8,6
34,6	34,7		**34,6**	34,7
		Capital expenditure will be financed from short-term borrowings. All expenditure will be incurred in the next financial year.		
		26. CONTINGENT LIABILITIES		
		26.1 Guarantees		
		The following guarantees were issued by the Group:		
1 096,7	1 166,7	Advance payments guarantees	**1 096,7**	1 166,7
664,7	643,5	Performance guarantees	**664,7**	643,5
12,4	14,2	Participating guarantees	**12,4**	14,2
3,5	3,4	Guarantees to local authorities	**3,5**	3,4
20,1	85,0	Sundry guarantees to banks for credit facilities of subsidiaries	**20,1**	85,0
208,2	203,8	Sundry guarantees	**208,2**	203,8
2 005,6	2 116,6		**2 005,6**	2 116,6
(919,2)	(997,6)	Recognised in the financial statements	**(915,1)**	(994,0)
(768,4)	(847,5)	Advance payments received	**(765,1)**	(844,3)
(150,8)	(150,1)	Provisions for guarantees (refer to note 23)	**(150,0)**	(149,7)
1 086,4	1 119,0		**1 090,5**	1 122,6
		A wholly-owned subsidiary of the Company has entered into an agreement for the purchase of certain agricultural products with Absa Bank Limited. The Company has undertaken to indemnify Absa Bank Limited against any loss which it may suffer as a result of a breach of the aforementioned agreement.		

26. CONTINGENT LIABILITIES (continued)

26.2 Contractual obligation

Due to the nature of the industry, there may be other contractual obligations in addition to those disclosed in note 23, which may result in future losses. The amount that may be involved cannot be reasonably determined.

26.3 Legal litigation

Legal litigation comprises of claims lodged and claims that may be lodged against the Group. Due to the sensitivity and the steps that will be taken to limit the contingent liability, specific disclosure of items may negatively influence the outcome and the Group's actions. The aggregate amount of significant claims lodged against the Company is R69,0 million. The directors are of the view that the success of most of the claims is remote and no material losses are expected to materialise from these claims.

26.4 Counter trade

The Group has entered into several export sale contracts that give rise to certain counter trade obligations. The obligations for current contracts varies from 60% to 100% of the export sale contract value.
These counter trade obligations can be fulfilled in one or a combination of the following:

- procurement of products and services from suppliers in the buyer's country;
- participating in a business venture in the buyer's country;
- exchanging counter trade credits that accrued to other companies in respect of a buyer's country for counter trade credits in South Africa.

The total value of the counter trade obligations based on sales already recognised is R312,4 million (2003: R246,1 million), translated at the year-end spot rate, the first of which needs to be fulfilled by May 2005. The Group has successfully negotiated agreements to exchange counter trade obligations for credits. These agreements plus accredited participations resulted in a net credit position (before obligations based on future deliverables) as some obligations for future sales were also settled. The Group is constantly exploring options to settle future counter trade obligations.

The maximum penalty applicable for counter trade obligations based on sales already recognised, excluding obligations already settled, is R5,2 million (2003: R20,7 million), this amount has been provided for as part of the contract risk provision (refer to note 23).

The counter trade obligations to be discharged are as follows:

Year ending	**2004** R million	2003 R million
31 March 2006	**66,3**	49,6
31 March 2007	**3,1**	–
31 March 2008	**80,0**	61,9
After 31 March 2008	**163,0**	134,6
Obligation based on deliveries	**312,4**	246,1
Obligation based on future deliveries	**854,7**	942,3
Counter trade obligation already discharged	**(528,6)**	–
Net counter trade obligation	**638,5**	1 188,4

The Company has entered into certain export contracts in which it is unclear if it is responsible for the respective counter trade obligations. Negotiations in respect of these counter trade obligations are in progress. The maximum liquidation damages concerning these contracts will be R7,6 million.

The Company has entered into a local defence contract and as a result the Company has an obligation to ensure that the counter trade relating to the foreign content is performed. The Company has therefore entered into back-to-back agreements with the suppliers to ensure that this obligation is off-set. The Company received bank guarantees from all the said suppliers which were ceded to the client. A portion of the estimated foreign content is not yet contracted and the company is currently carrying an obligation for which a bank guarantee to the value of R5,0 million was issued to the client to cover liquidation damages in case the counter trade obligation is not met. The Company is currently in negotiations to conclude the outstanding portion.

27. RELATED PARTIES

Major shareholder

The shareholder of Denel (Pty) Limited is the South African Government.

Transactions with directors

There are no material transactions with the directors other than the directors' emoluments detailed in the Directors' report.

Transactions with entities in the Group

Denel (Pty) Limited is the ultimate parent company in the Group. The Company advances loans to these entities in the Group during the current and previous financial years as part of financing them. Other transactions within the Group were on commercial terms and conditions.

28. FINANCIAL RISK MANAGEMENT

Due to the nature and diversity of the activities performed by the Group, the Group is exposed to various financial risks. The Group regards financial risk management as a fundamental part of the management process and accordingly senior staff are involved with the development of the risk policies and in monitoring its application.

The Board has delegated the financial risk management function to the Board Treasury Committee. The committee meets regularly and has both internal and external specialist representation.

Fair value

At 31 March 2004 and 2003 the carrying amounts of cash, cash equivalents, accounts receivable, accounts payable and current borrowings approximated their fair values due to the short-term maturities of these assets and liabilities. The fair value of bonds listed on the Bond Exchange of South Africa and those of derivative financial instruments are measured at the quoted market bid price for assets held or liabilities to be issued or the offer price for assets to be acquired or liabilities held at the reporting date. The fair values represent an approximation, but these may differ from the values that will finally be realised.

Financial assets and liabilities are recognised at fair value except the following:

	GROUP		COMPANY	
	Carrying value 2004 R millions	Fair value 2004 R millions	Carrying value 2004 R millions	Fair value 2004 R millions
Local secured loan (refer to note 22)	**20,3**	**20,5**	**16,6**	**16,8**
Local unsecured loan (refer to note 22)	**821,1**	**886,6**	**821,1**	**886,6**

The following is a summary of the most important financial risks to which Denel is exposed, and an indication of how these risks are managed:

Credit/counterparty risks

Credit risk is the risk that a customer or counterparty of the Group will be unable or unwilling to meet a commitment it has entered into with the Group.

Trade debtors comprise mainly of governments (local and foreign) and credit risks evaluations are performed on a regular basis. Where appropriate, credit insurance cover is purchased for pre-delivery and payment risks, irrevocable letters of credit and advance payments are negotiated. The Board Treasury Committee is responsible for making recommendations to the Board on limits for banks and reviewing it on a regular basis.

At balance sheet date there were no significant concentrations of credit risks.

Liquidity risk

The centralised treasury manages the liquidity structure of the Group's assets, liabilities and commitments so as to ensure that cash flows are sufficiently balanced within the Group as a whole. Updated cash flow information and projections of future cash flows are received from divisions and subsidiaries on a daily, weekly and monthly basis. Measures have been introduced to ensure that the cash flow information received is accurate and complete.

To ensure liquidity, investment of surplus funds is made in liquid assets (eg negotiable certificates of deposits and call deposits). Refer to note 19.

28. FINANCIAL RISK MANAGEMENT (continued)

Interest rate risk

Interest rate risk arises due to adverse movements in the market interest rates. The Board Treasury Committee determines the interest rate risk strategy based on economic expectations. Interest rates are monitored on a daily basis. Refer to note 22.

Currency risk

Currency risk arises from the movement in foreign exchange rates. As the Group has substantial foreign currency exposure, currency risk is managed on a continuous basis. The centralised treasury hedges the foreign currency exposure for recognised and anticipated transactions according to the foreign exchange policy, using foreign exchange contracts and options. No transactions of a speculative nature are undertaken.

Bank accounts of foreign entities and foreign offices are not hedged as well as proceeds received from export contracts that will be used to pay foreign suppliers on the same contract as it forms a natural hedge. Amounts in the foreign bank accounts representing proceeds received awaiting conversion to South African rand are hedged by the foreign currency derivatives.

Foreign currency derivatives

The fair value of foreign currency derivatives are disclosed in note 18.
The following foreign exchange contracts existed at year-end:

	2004		2003	
	Foreign currency notional amount Millions	**Local currency amount Millions**	Foreign currency notional amount Millions	Local currency amount Millions
The following foreign exchange contracts existed at year-end:				
Purchase contracts				
US dollar (USD)	**15,6**	**144,9**	17,9	172,4
Euro (EURO)	**4,6**	**40,5**	4,7	45,6
Sterling (GBP)	**0,4**	**5,1**	0,6	9,2
Swiss franc (CHF)	**0,2**	**1,1**	0,1	0,9
Singapore dollar (SGD)	**0,3**	**1,3**	0,5	2,3
Australian dollar (AUD)	**0,1**	**0,3**	0,2	1,1
Other		**0,2**		–
		193,4		231,5
Sales contracts				
US dollar (USD)	**78,7**	**590,1**	80,5	776,9
Euro (EURO)	**5,9**	**49,1**	1,4	13,5
Sterling (GBP)	**1,6**	**3,4**	0,6	6,5
Swiss franc (CHF)	**0,1**	**0,4**	–	–
Singapore dollar (SGD)	**9,3**	**43,9**	22,2	129,6
Australian dollar (AUD)	**7,2**	**35,6**	17,1	93,4
		722,5		1 019,9
The following foreign exchange options existed at year-end:				
Sales contracts				
US dollar (USD)	**89,0**	**659,6**	11,9	111,9
Euro (EURO)	**10,2**	**90,0**	5,0	43,9
Sterling (GBP)	**0,6**	**7,5**	0,7	8,4
Australian dollar (AUD)	**11,6**	**54,0**	–	–
		811,1		164,2

Maturity table	Foreign currency notional amount Millions 1 Year	Millions 2 Years	Millions 3-5 Years	Millions Total

28. FINANCIAL RISK MANAGEMENT (continued)

The following table sets out the maturity of foreign exchange contracts:				
Purchase contracts				
US dollar (USD)	15,2	0,4	–	15,6
Euro (EURO)	4,0	0,6	–	4,6
Sterling (GBP)	0,4	–	–	0,4
Swiss franc (CHF)	0,2	–	–	0,2
Singapore dollar (SGD)	0,3	–	–	0,3
Australian dollar (AUD)	0,1	–	–	0,1
Sales contracts				
US dollar (USD)	74,6	4,1	–	78,7
Euro (EURO)	5,4	0,5	–	5,9
Sterling (GBP)	1,5	0,1	–	1,6
Swiss franc (CHF)	0,1	–	–	0,1
Singapore dollar (SGD)	9,3	–	–	9,3
Australian dollar (AUD)	7,2	–	–	7,2
The following table sets out the maturity of foreign exchange options:				
Sales contracts				
US dollar (USD)	46,4	27,4	15,2	89,0
Euro (EURO)	5,4	0,1	4,7	10,2
Sterling (GBP)	0,6	–	–	0,6
Australian dollar (AUD)	11,6	–	–	11,6

Foreign exchange embedded derivatives

A contract (sales or purchase) denominated in a foreign currency, which is neither the measurement currency of any party to the contract nor the currency in which the commodity is routinely traded in international commerce contains a foreign exchange embedded derivative (to sell or buy the equivalent amount of foreign currency), which has been separated and accounted for at fair value even though the contract is not recognised.

Foreign currency	Foreign currency notional amount USD (millions)	Local currency amount R millions	Fair value R millions
Export transactions	157,4	1 467,8	1 078,2
Import transactions	8,0	78,2	54,5

Maturity table	Foreign currency notional amount 1 year USD (millions)	2 years USD (millions)	3 – 5 years USD (millions)	Total USD (millions)
Export transactions	117,4	28,5	11,5	157,4
Import transactions	5,7	1,5	0,8	8,0

Country risk

Country risk is risk of entering into transactions with counterparts in another country. Published external ratings are obtained, reviewed and distributed within the Group. These ratings are used as a first tier for country risk management.

Country risk information is obtained from banks and credit insurers in cases where a possibility of contracts exists. Where appropriate, credit insurance cover is purchased, irrevocable payment instruments and advance payments are negotiated.

29 PENSION AND OTHER POST-RETIREMENT OBLIGATIONS

Defined benefit plans

Denel Pension Fund

The Group has established a pension fund scheme that covers certain employees. This fund is a final salary defined benefit plan and is fully funded. The assets of the funded plan are held independently of the Group's assets in a separate trustee administered fund. The fund is governed by the Pension Funds Act of 1956 (Act No 24 of 1956).

This scheme is valued by independent actuaries every three years using the projected unit credit method. The latest full actuarial valuation was prepared for 31 December 2001. A preliminary actuarial calculation was performed as at the balance sheet date. No adjustments were made in the financial statements due to the fact that the pension fund had an estimated actuarial surplus of R1 224,9 million (2003: R983,6 million) at balance sheet date. The employer utilised a contribution holiday of R0,0 million (2003: R1,2 million).

Post-employment medical benefits

The group provides post-retirement medical aid contribution subsidies to qualifying retirees.

The actuarially calculated liability compared to assets is as follows for the defined benefit plans:

	Denel Pension Fund		Denel Medical Benefit Trust	
	2004	2003	**2004**	2003
	R millions	R millions	**R millions**	R millions
Change in defined benefit funded obligation				
Present value of funded obligations at beginning of year	**1 716,5**	1 651,0	**653,4**	552,8
Service cost benefits earned during the year	**1,0**	1,0	**17,8**	13,2
Interest cost on projected benefit obligation	**180,8**	205,6	**78,4**	66,3
Actuarial loss	**58,8**	–	**71,3**	38,4
Benefits paid	**(157,8)**	(141,7)	**(20,2)**	(17,3)
Member contribution	**0,6**	0,6	**–**	–
Present value of funded obligations at end of year	**1 799,9**	1 716,5	**800,7**	653,4
Change in plan assets				
Fair value of plan assets at beginning of year	**2 700,1**	2 967,2	**748,7**	708,7
Expected return on plan assets	**288,8**	376,6	**224,5**	55,3
Actuarial gain/(loss)	**192,0**	(502,7)	**–**	–
Employer and member contribution	**1,7**	0,7	**3,3**	2,0
Benefits paid	**(157,8)**	(141,7)	**(20,2)**	(17,3)
Fair value of plan assets at end of year	**3 024,8**	2 700,1	**956,3**	748,7
Fund excess	**1 224,9**	983,6	**155,6**	95,3
Excess not recognised	**1 224,9**	983,6	**155,6**	95,3
Net benefit expenses				
Service cost	**1,0**	1,0	**17,8**	13,2
Interest cost	**180,8**	205,6	**78,4**	66,3
Expected return on plan assets	**(288,8)**	(376,6)	**(224,5)**	(55,3)
Net actuarial loss recognised in year	**27,5**	–	**71,3**	38,4
Income	**(79,5)**	(170,0)	**(57,0)**	62,6

	Denel Pension Fund		Denel Medical Benefit Trust	
	2004	2003	**2004**	2003

29 PENSION AND OTHER POST-RETIREMENT OBLIGATIONS (continued)

	Denel Pension Fund 2004	Denel Pension Fund 2003	Denel Medical Benefit Trust 2004	Denel Medical Benefit Trust 2003
The principal actuarial assumptions used for accounting purposes were:				
Expected return on plan assets (%)	**11,00**	13,00	**11,00**	12,00
Future salary increases (%)	**7,50**	9,50		
Future pension increases (%)	**6,00**	8,00		
Discount rate (%)	**11,00**	13,00		
Inflation rate (%)	**6,00**	8,00		
Expected medical inflation (%)			**9,00**	10,00
The beneficiary members from the funds are as follows:				
Active members	**76**	76	**4 433**	4 689
Retired members	**3 303**	3 594	**2 582**	2 557

Denel Retirement Fund

The Group has established a retirement fund scheme that covers all qualifying employees except those who are members of the Denel Pension Fund. This fund is a defined contribution plan. The employer utilised a contribution holiday of R52,8 million (2003: R75,2 million). The fund is governed by the Pension Funds Act of 1956 (Act No 24 of 1956).

There are 7 918 active members (2003: 7 559) and 702 pensioners (2003: 632).

Denel Supplementary Provident Fund

The Group has established a supplementary provident fund for qualifying executives to enhance pension benefits. The fund is operated as a defined contribution plan, except for a few remaining members where the final benefits are linked to salary.

During 2001/02 the Denel Board resolved to liquidate the fund and the liquidation process commenced in May 2003.

The latest preliminary actuarial valuation was carried out as at 7 May 2003 reflected an estimated actuarial surplus of R11,6 million (2003: R8,0 million). No contributions have been made to the fund subsequent to the liquidation. No further disclosure is done as the fund is in the process of liquidation and there is an estimated actuarial surplus.

Contingent liability

In terms of the second amendment act to the Pension Fund Act of 1956, promulgated on 7 December 2001, the Group has a possible contingent liability to the Denel Pension Fund and Denel Retirement Fund at year-end for amounts defined in the act as misappropriation.

Section 15b of the amendment act states that the employer may be required to refund a portion of or the full amount utilised as a contribution holiday subsequent to 7 December 2001 to the Pension Fund.

30. CHANGE IN ACCOUNTING POLICY

During the year, the Group adopted the Generally Accepted Accounting Practice statement AC133: Financial Instruments: Recognition and Measurement. The requirements set out in this statement need to be applied and regarded as standard for financial statements covering all periods commencing on or after 1 July 2002. Comparative figures have not been restated as the statement does not require restatement of comparatives. The effect of the adoption is as follows:

	Group 2004 R million	Company 2004 R million
Increase/(decrease) in net profit/(loss) for the year		
Foreign exchange embedded derivatives released during the year	337,3	337,3
Sales	368,3	368,3
Cost of sales	(33,0)	(33,0)
Operating expenses	2,0	2,0
Interest	2,0	2,0
Fair value adjustment of investment	0,6	0,6
Market interest rate adjustment	1,4	1,4
Foreign exchange losses	(452,2)	(452,2)
Foreign exchange embedded derivatives	(452,8)	(452,8)
Derivatives		
Foreign exchange contracts with no underlying asset or liability	(59,5)	(59,5)
Foreign exchange options with no underlying asset or liability	60,1	60,1
Net decrease in loss for the year	(112,9)	(112,9)
Decrease in retained earnings opening balance	(157,0)	(157,0)
Foreign exchange embedded derivatives	(225,9)	(225,9)
Derivatives	71,8	71,8
Interest	(2,9)	(2,9)
Impact on year-end reserves	(269,9)	(269,9)

31. COMPARATIVES

Comparative figures have been reclassified in certain line items in the annual financial statements to achieve a better understanding of the financial statements.

The comparatives for other receivables (refer to note 17) and other accruals (refer to note 24) have been separately disclosed to show the derivative asset and liability separately due to the adoption of AC133.

The disclosure of pension and other post-retirement benefits (refer to note 29) has been changed to ensure compliance with AC116.

32. SUBSEQUENT EVENTS

Subsequent to year-end a commercial paper programme facility for R500 million was approved of which R250 million has been accessed subsequent to year-end.

The South African rand has continued to strengthen against major currencies, and this will have a negative impact on the profitability of the Group in the future. The strengthening of the South African rand will however not have a significant impact on the results of 2004/05 as most of the export orders have either been hedged by forward exchange contracts or foreign exchange options.

The directors are not aware of any other matter or circumstance since the financial year-end and the date of this report, not otherwise dealt with in the financial statements, which may significantly affect the financial position of the Group and the results of its operations.

SUBSIDIARIES AND ASSOCIATED COMPANIES

	2004			
	Share capital issued* R millions	Share investment by Denel (Pty) Limited* R millions	Amounts owing to/(by) Denel (Pty) Limited* R millions	Effective percentage shareholding %
The following unlisted companies are subsidiaries or associated companies of Denel (Pty) Limited or of its subsidiaries:				
SHAREHOLDING BY HOLDING COMPANY				
Aero Properties (Pty) Limited	–	–	18,7	100,0
Bonaero Park (Pty) Limited	27,0	126,1	(112,8)	100,0
Denel Informatics Marketing in Africa (Pty) Limited	–	–	0,3	100,0
Denel International Ltèe (incorporated in Mauritius)	–	–	62,8	100,0
Denel Personnel Solutions (Pty) Limited	–	–	(29,6)	100,0
Denel Properties (Pty) Limited	–	–	111,1	100,0
Densecure (Pty) Limited	8,0	8,0	–	100,0
Irenco (Pty) Limited	–	–	158,1	100,0
I P S (Pty) Limited	–	–	–	100,0
La Forge (Pty) Limited	–	–	38,9	100,0
Provectus (Pty) Limited	–	–	–	–
Skew Road Properties (Pty) Limited	–	3,6	3,2	100,0
Southern Space (Pty) Limited	–	–	–	–
Specialised Protein Products (Pty) Limited	–	–	311,7	100,0
Summit Space SA (incorporated in Switzerland)	0,3	0,3	–	100,0
Sybase SA (Pty) Limited	–	18,2	12,6	51,0
Uitzicht Restaurant (Pty) Limited	–	–	–	–
Total of investment		156,2	575,0	
Less: Impairment of investment		(12,0)	(400,6)	
Net investment of Denel (Pty) Limited		144,2	174,4	
SHAREHOLDING BY SUBSIDIARIES				
Jagarve (Pty) Limited	–	–	–	100,0
Nisec (Pty) Limited	–	–	–	100,0
SQL Solutions (Pty) Limited	–	–	–	51,0
Sybase SA (Cape) (Pty) Limited	–	–	–	26,0
ASSOCIATED COMPANIES				
Flowtite Botswana Limited (incorporated in Botswana)	–	–	–	–
Ariviakom (Pty) Limited	0,5	151,6	–	23,0
Cosource (Pty) Limited	–	45,9	–	47,4
Turbomeca Africa (Pty) Limited	–	28,8	20,6	49,0
Total of investment		226,3	20,6	
Less: Impairment of investment		(28,8)	(20,6)	
Net investment of Denel (Pty) Limited		197,5	–	

** Amounts smaller than R100 000 are not reflected on this page*

	2004 R million	2003 R million
Aggregate profit/(loss) of subsidiaries	(107,7)	(99,1)

	2003			
	Share capital issued* R millions	Share investment by Denel (Pty) Limited* R millions	Amounts owing to/(by) Denel (Pty) Limited* R millions	Effective percentage shareholding %
The following unlisted companies are subsidiaries or associated companies of Denel (Pty) Limited or of its subsidiaries:				
SHAREHOLDING BY HOLDING COMPANY				
Aero Properties (Pty) Limited	–	–	15,6	100,0
Bonaero Park (Pty) Limited	27,0	126,1	(92,2)	100,0
Denel Informatics Marketing in Africa (Pty) Limited	–	–	0,3	100,0
Denel International Ltèe (incorporated in Mauritius)	–	–	62,8	100,0
Denel Personnel Solutions (Pty) Limited	–	–	(96,2)	100,0
Denel Properties (Pty) Limited	–	–	100,5	100,0
Densecure (Pty) Limited	8,0	8,0	–	100,0
Irenco (Pty) Limited	–	–	139,8	100,0
I P S (Pty) Limited	–	–	68,2	100,0
La Forge (Pty) Limited	–	–	30,1	100,0
Provectus (Pty) Limited	–	–	–	100,0
Skew Road Properties (Pty) Limited	–	3,6	2,6	100,0
Southern Space (Pty) Limited	–	–	–	100,0
Specialised Protein Products (Pty) Limited	–	–	261,1	100,0
Summit Space SA (incorporated in Switzerland)	0,3	0,3	–	100,0
Sybase SA (Pty) Limited	–	18,2	8,0	51,0
Uitzicht Restaurant (Pty) Limited	–	–	–	100,0
Total of investment		156,2	500,6	
Less: Impairment of investment		(12,0)	(293,2)	
Net investment of Denel (Pty) Limited		144,2	207,4	
SHAREHOLDING BY SUBSIDIARIES				
Jagarve (Pty) Limited	–	–	–	100,0
Nisec (Pty) Limited	–	–	–	100,0
SQL Solutions (Pty) Limited	–	–	–	51,0
Sybase SA (Cape) (Pty) Limited	–	–	–	26,0
ASSOCIATED COMPANIES				
Flowtite Botswana Limited (incorporated in Botswana)	–	–	–	13,0
Ariviakom (Pty) Limited	0,5	151,6	–	23,0
Cosource (Pty) Limited	–	37,2	–	43,0
Turbomeca Africa (Pty) Limited	–	28,8	21,6	49,0
Total of investment		217,6	21,6	
Less: Impairment of investment		–	–	
Net investment of Denel (Pty) Limited		217,6	21,6	

** Amounts smaller than R100 000 are not reflected on this page*

REPORT OF THE INDEPENDENT AUDITORS TO THE MINISTER OF PUBLIC ENTERPRISES IN TERMS OF THE PUBLIC FINANCE MANAGEMENT ACT (PFMA), 1 OF 1999

We have audited the Company and Group consolidated annual financial statements of Denel (Proprietary) Limited set out on pages 48 to 97 for the year ended 31 March 2004. Our audit opinion under the Companies Act, 1973 is set out in page 47. The annual financial statements are the responsibility of Denel (Proprietary) Limited's accounting authority. Our responsibility is to express an opinion on these financial statements based on our audit.

The performance information contained in the annual report for the year ended 31 March 2004 as set out on pages 50 and 51 is the responsibility of the accounting authority. Our responsibility is to express an opinion on whether the performance information, furnished in terms of subsection 55(2)(a) read in conjunction with subsection 61(1)(b) of the PFMA, 1 of 1999, as amended, is fair in all material respects, and has been prepared on a basis consistent with that of the preceding year.

SCOPE

We conducted our audit in accordance with statements of South African Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. The audit was also planned and performed to obtain reasonable assurance that our duties in terms of section 60 and 61 of the PFMA, 1 of 1999, as amended, have been complied with. An audit includes:

- Examining, on a test basis, evidence supporting the amount and disclosures in the financial statements;
- Assessing the accounting policies used and significant estimates made by management; and
- Evaluating the overall financial statements presentation.

We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion:

- The financial statements fairly present, in all material aspects, the financial position of Denel (Proprietary) Limited and the Group at 31 March 2004, and the results of their operations and cash flows information for the year then ended as required by the PFMA, 1 of 1999, as amended.
- The financial aspects of the performance information furnished in terms of sub-section 55(2) of the PFMA, 1 of 1999, as amended, fairly present, in all material respects, Denel (Proprietary) Limited's and the Group's performance for the year ended 31 March 2004 against the predetermined objectives, and where applicable, consistent with the preceding year. We have not audited the qualitative performance information contained in the performance information and accordingly do not express an opinion thereon.
- The transactions of Denel (Proprietary) Limited and the Group that have come to our attention during our audit were in all material respects, in accordance with the mandatory functions of the company, as determined by law.

CERTAIN SECTIONS OF PFMA

Without qualifying our opinion expressed above, we draw attention to the Directors' Report on the Public Finance Management Act, which states that the company has not fully complied with certain sections of the PFMA.

SizweNtsaluba VSP Inc	**Ernst & Young**
Chartered Accountants (SA)	*Chartered Accountants (SA)*
Registered Accountants and Auditors	*Registered Accountants and Auditors*
Johannesburg	Johannesburg
3 August 2004	3 August 2004

CONTACT DETAILS

DENEL (PTY) LIMITED

Registration number 1992/001337/07

The registered office of Denel (Pty) Limited is situated at:
Denel Building
Jochemus Street
Erasmuskloof
Pretoria 0001
South Africa

The postal address of the Company is:
PO Box 8322
Centurion 0046
South Africa

Other contact details are:
Telephone +27 12 428 0802
Fax +27 12 428 0783

E-mail info@denel.co.za

Website www.denel.co.za

CURRENCY OF ANNUAL FINANCIAL STATEMENTS

The annual financial statements are expressed in South African rand (R). The approximate buying rate of R1,00 at 31 March was:

	2004	2003
US dollar (USD)	**0,1576**	0,1256
Euro (EUR)	**0,1276**	0,1152
Sterling (GBP)	**0,0859**	0,0795
Swiss frank (CHF)	**0,2009**	0,1700
Japanese yen (YEN)	**16,3793**	14,8957