

Annual Report '08



ARMSCOR

Armaments Corporation of South Africa Ltd

Gateway to defence solutions



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Vision

Armcor's vision is to be a truly South African organisation that is valued locally and globally as a centre of technical excellence for defence acquisition and support services.

Mission

Armcor's mission is to meet the acquisition, maintenance and disposal needs of the South African Department of Defence and other clients in terms of defence matériel, related products and services. Armcor maintains strategic capabilities and technologies and promotes the local defence-related industry.

Values

Armcor believes that its values constitute the building blocks of the manner in which it conducts its business. We believe in the highest standards and are committed to equal opportunities, transparency and accountability. We pledge commitment to the following values: Leading by example, results driven, customer focus, care and respect for others, excellence, teamwork and integrity.

Corporate profile

Armcor is a statutory body. The Minister of Defence is the Executive Authority responsible for Armcor. The management and control of Armcor reside with a Board of Directors, whilst its day-to-day management vests in the hands of the Management Board.

In the execution of its functions Armcor has established and maintains capabilities and technologies that are required to fulfil its mandate, such as appropriate programme management systems, the Defence Industrial Participation (DIP) programme, the management of technology projects and strategic facilities.

Armcor as an acquisition agency

Armcor acquires defence matériel for the Department of Defence (DOD) and for any organ of State that may require such services, such as the South African Police Service (SAPS).

The acquisition role of Armcor pertains to all the actions that need to be taken to satisfy the need for matériel, facilities or services intended for client use or in support of client requirements. These actions include long-term operational research, requirement planning, establishment and development of technology, design and development of products and systems aimed at industrialisation, and manufacturing of mature products and systems that fully meet the stated user requirements. The acquisition role can be broadly divided into the following four categories: System acquisition management, procurement management, product systems management and technology acquisition management.

Armcor, in addition, also performs the following functions:

- Quality assurance;
- Defence Industrial Participation (DIP); and
- Management of strategic facilities.

The management of strategic facilities is vested in a subsidiary company, Armcor Business (Pty) Limited.

To fulfil this mandate, Armcor Business is structured into three groups, namely:

- Defence Science and Technology Institute, which houses the research and development facilities; Test and Evaluation Centre, which is responsible for rendering comprehensive test and evaluation services in both the military and civilian environment; and
- Defence Support, which is responsible for defence matériel disposal, configuration management, data management and the provision of freight and travel logistics.

Chairman's report



Dr PS Molefe

Chairman - Armscor

Armscor remains firmly a corporation of Government for the acquisition of defence matériel. This was reconfirmed on the 6th of December 2007 through an approval by the Honourable Minister of Defence, Mr MGP Lekota of the Armscor Transformation Desktop Study on the Preferred Future Corporate Form for Armscor which is the Blue Print for the Transformation of Armscor.

This day hailed a new beginning for the organisation and a sharp focus on its mandate into the future. Most importantly, the decision brought finality to the uncertainty that prevailed in the organisation and the industry on the role and location of Armscor post the transformation process.

I am indebted to my Board colleagues ably supported by the joint technical project team of the Department of Defence and Armscor for developing the Blue Print document. This document embodies a comprehensive view of *inter alia* the:

- Strategic positioning domestically and internationally of Armscor within a continuous evolving and cutting edge defence industry,
- Re-definition of the core business of Armscor which is "the acquisition, delivery and maintenance of defence equipment which involves serving as an interface

between the defence and industrial/commercial environment, distinct from broader defence tasks",

- Acknowledgement that the execution of the required functions is critically dependent on a stable workforce that is technically competent in project and program management, the appropriate and diverse support expertise in quality, legal, compliance, management and financial disciplines which provides continuity over the total life cycle of programs.

The consolidation in the industry that I referred to last year is already beginning to take shape. This is evidenced by the soon to be finalised Defence Evaluation and Research Institute (DERI) which will be responsible for the defence technology, research and development, test and evaluation capability in the country. This will be a new centre of excellence consolidating the capabilities and building a critical mass to address strategic capabilities that have seen a steady decline in the past. South Africa must maintain these specialised and strategic capabilities in order to keep abreast with developments in the complex defence industry.

The key aspect of the transformation entails the removal of the defence technology, research and development, test and evaluation capability from Armscor so that these strategic capabilities are consolidated with similar capabilities from the other departments within government. The DERI migration necessitates the reintegration into Armscor of the business units of Armscor Business (Pty) Ltd., a subsidiary of Armscor, that do not form part of the DERI. This will enhance the capability of Armscor to better serve its client and will take place during April 2008.

Armscor's mandate

The approval of the Blue Print for the transformation of Armscor means a redefinition of the mandate of the organisation arising from the Armscor Act 51 of 2003. Armscor's objective is to meet the defence matériel requirements of the Department of Defence (DOD) effectively, efficiently and economically. The new mandate excludes the requirement to meet the defence technology, research and development, analysis, test and evaluation of the DOD which will henceforth be delivered by the DERI.

The responsibility of transforming the organisation was a critical task that the Shareholder gave to the Board

Chairman's report (continued)

through the Shareholder Compact. This was in addition to the Board's statutory mandate. Whilst this task has been achieved with the approval by the Shareholder of the Blue Print, the implementation thereof becomes the next level challenge that the Board will be ceased with in the new financial year. To this end, the Shareholder Compact already articulates the implementation deliverables for the new financial year.

Corporate governance

Arm Scor is committed to and continues to comply with good corporate governance principles. In general, Arm Scor endeavoured to act in a manner that reflects this commitment. In a matter of a grievance by the General Manager of Corporate Affairs against the Chief Executive Officer, the Board took longer than it would otherwise have wished in making a decision, a delay which is truly regretted. There were however mitigating factors including the circumstances of the matter, capacity of the Board at the time and other urgent issues that were placed before the Board made it impossible to only prioritise this matter to the exclusion of strategic matters such as the Arm Scor transformation, the Vistula investigation to name but the few. I am confident that the interventions by the Minister to address capacity in the Board will enable the Board to deal with its business more expeditiously into the future.

The organisation has aligned its governance instruments to enhance accountability and to ensure that reporting is done in a consistent manner. The targets as contained in the Shareholder Compact, Service Level Agreement (SLA) and corporate plan were streamlined with this objective in mind. This alignment has enhanced the turnaround in driving the strategic issues that the Board of Directors must of necessity give leadership to.

The core business of Arm Scor which is the acquisition of defence matériel is undertaken through the SLA. This contractual instrument provides for better accountability, transparency, efficiency and effectiveness for the utilisation of the resources of the State. The SLA was upgraded during the year under review to streamline the deliverables by Arm Scor to the Department of Defence. The updated SLA will make accountability by the Board for the Special Defence Account and General Defence Account funds that are put at Arm Scor's disposal easier to manage.

The upgraded SLA responds better to the current socio-economic and developmental agenda of the government, which demands that a fully transparent system of expending the resources of the State be in place.

Capacity in the Board

The year under review saw the Board operating with limited capacity which caused delays in the finalisation of sensitive matters in the organisation. Whilst the lack of capacity in any Board is unfortunate, in this case, it was necessary as the Shareholder needed time to consider the end state of the restructured organisation which might not have required a Board of Directors. In addition and most importantly, the DOD and the Board had to finalise the Blue Print for the Arm Scor transformation before the old Board was retired. The net result of all this was that Board members whose terms of office had expired could not be replaced until the Arm Scor transformation was concluded.

Forensic Accounting Investigation into possible irregularities relating to orders placed with Defence Institute

As was reported in the Annual Report of 2006/07 Financial Year, Arm Scor management undertook an investigation into the internal systems of Defence Institute (DI) the business unit of Arm Scor Business (Pty) Ltd., a subsidiary of Arm Scor after allegations had been made that DI had *inter alia* overcharged Arm Scor for professional services rendered to the tune of R7, 8 million and non-compliance with the Public Finance Management Act (PFMA) and other legal prescripts and policies of government. This matter has since been finalised with the Gobodo Forensic Report recommending some interventions on the findings, which have been put in place.

The Senior Counsel's report which had to consider whether there was a contravention with the PFMA concluded that neither the DI nor the Arm Scor Board had contravened the provision of the PFMA and the policies of government.

Vistula Project

The Board cancelled the Vistula tender process as none of the bidders met the critical criteria. In addition, there was non-compliance with Arm Scor tender processes and practices.

Chairman's report *(continued)*

The recurring, non-recurring and legal costs to Armscor for the cancellation of this tender amounted to R12 209 357,18. The non financial costs of the cancellation of the project can never be quantified in monetary terms. The cancellation meant that there would be a delay for the client to receive the necessary equipment. The Board, however, took into account the risk of continuing with the tender where none of the bidders met the critical criteria and getting the product that in the long run could have been problematic to the client, the Department of Defence, and concluded that it was more prudent to cancel the tender and restart the process in order to enable new bids to meet the critical criteria. We have since engaged the client with a view to facilitating a new tender which is to be re-issued as soon as possible. Furthermore, a rigorous process of review and upgrading of the internal processes and systems was undertaken.

The Grievance by the General Manager: Corporate Affairs against the Chief Executive Officer

As referred to above, there had been a delay in the finalisation of this matter with a very detailed process followed by the Human Resources Committee which was mandated to investigate this matter and to make recommendations to the Board for consideration. The final recommendation of the Human Resources Committee would be tabled before the full Board in June 2008. Whilst the report was submitted by the Human Resources Committee just before the end of the financial year, it could not be dealt with any sooner as at that time the majority of the members of the Board were retired after already having served two terms of office allowed by law. This meant that the matter needed to be introduced to the new Board members, who would consider it in June. Our wish was to have this matter finalised soon.

Dispute on performance pay

During the year under review, the Armscor Board of Directors resolved not to pay for performance of the 2006/07 financial year. The reason for the decision was that the organisation did not meet the criteria for payment for performance. The criterion that was adopted in 2006 was for the payment of performance pay based on the 100% achievement by the Chief Executive Officer of the performance objectives set out in the latter's Balanced Scorecard. The Chief Executive Officer did not achieve the

100% performance target and therefore no performance pay could be made to the organisation.

The Board reconsidered the matter and came to the conclusion that the method used was inadequate and prejudicial to the employees who performed well. Accordingly, it decided to reverse its previous decision. A more efficient system is being developed which will be objective, sustainable, transparent and fair to the entire organisation.

The year's overview

Armscor continues to display commitment and technical expertise in delivering the Strategic Defence Package (SDP) programmes in support of the DOD. The delivery of the SDP's enhances South Africa's ability to protect and defend her Constitution by protecting her sovereignty at sea, in air and on land. The SDP also enables South Africa to deploy the state of the art equipment in the various peace keeping and other missions that she is and will continue to be involved in.

During the year under review, the last three of the four Frigates were commissioned and handed over to the SA Navy. In addition, all four maritime Patrol Helicopters were delivered in July 2007 and the Minister of Defence handed over these assets to both Chief of Air Force and Chief of SA Navy.

The second submarine SAS Charlotte Maxeke arrived in Simon's Town in April 2007 and the third submarine SAS Queen Mojadji is expected to arrive in RSA in May 2008. Finally, the delivery and commissioning of a further 5 of the Hawk Lead-in Fighter Trainer Aircraft was achieved during the period under review.

Cardinal Programmes

Cardinal Programmes progressed well with highlights achieved such as A-Darter Short range Air to Air missile development by Denel and co-funded by the Brazilian Air Force has completed the first year of development.

Armscor has been vigilant in the management of the DIP obligations to ensure the industry growth. This instrument assisted in stabilising the industry which saw decreasing defence budgets over the years.

Chairman's report (continued)

Transfer of the Dockyard to Armscor

The Dockyard was transferred to Armscor in September 2007 after the court found in favour of Government and Armscor in the dispute that was lodged in the Labour Court by NEHAWU, the majority union in the Dockyard. The decision enabled the transfer of the Dockyard to Armscor to be implemented. The Dockyard is now being integrated into Armscor.

Acknowledgements

The leadership, resolve and the support that the Minister of Defence, Honourable MGP Lekota, and his deputy, ME George made possible the overall performance of Armscor, and effective discharge of its mandate.

I am indebted to the Secretary for Defence, Mr JB Masilela, Chief of the SANDF, Gen G N Ngwenya, Chief of the Navy, Vice-Admiral J Modimu and the Chief of Defence Matériel Division, Mr B Ramfolo for their support, without which Armscor could not have made the strides it did.

My special thanks go to the clients of Armscor in particular the DOD and all arms of service, without whose business Armscor would have no reason to exist. In addition, my thanks go to the South African Police Service and South African Correctional Services for their loyal support over the years.

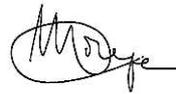
The defence-related industry under the leadership of the South African Aerospace Maritime and Defence Industry Association continues to contribute effectively to the development of the organisation through ongoing engagements, and for that I am grateful.

I am thankful to the Parliament's Portfolio Committee on Defence for its guidance and the robust oversight it has provided during the year.

My special thanks goes to all Board members for their guidance, leadership and oversight role that the Board played during the year under review. I also extend my gratitude to the outgoing board members Ms P Human, Ms P Riba, Col (Ret) GN Ramaremsa and Mr CV Gamede for their selfless contributions that enriched the business of Armscor. I wish them very well into the future.

My unreserved appreciation goes to the Armscor Management Board and all Armscor employees for their commitment and diligence that continued to make Armscor an organisation that many aspired to work for. The professionalism that the organisation displayed in the discharge of its responsibilities continued to make Armscor an engineering centre of excellence in the country.

The horizon is full of promise for a new transformed Armscor in its endeavour to reposition and reassert itself in the industry, in South Africa and globally. I am confident that the leadership, oversight, technical expertise of the Armscor family will enable Armscor to deliver on its mandate.



DR PS MOLEFE

Chairman

Board of Directors



Dr PS Molefe
Chairman - Armscor



HS Thomo
Chief Executive Officer



RP Meyer



CJ Hoffmann
Chief Financial Officer



Col (Ret) GN Ramaremsa



CV Gamede



P Riba



AS Human

Chief Executive Officer's report



Mr HS Thomo

CEO - Armscor

During the year under review Armscor continued to demonstrate its commitment to support the Department of Defence (DOD) and the defence-related industry at large. The details of these achievements are covered extensively throughout this annual report.

The financial year also posed exciting challenges for Armscor. Several exciting developments took place during the period under review and all of these were intrinsic to the discharge of Armscor's mandate which focuses on the continuing strategic challenge of restructuring the Corporation and consolidating its relationship with the Executive Authority, namely the Minister of Defence (MOD) and the Department of Defence (DOD), to which it is accountable. This restructuring initiative and the achievement of the goals are highlighted in my report under the following headings:

- Funding of Armscor and the impact thereof
- Erosion of technical capabilities
- Rejuvenation of the workforce
- Restructuring of Armscor

- Defence environment analysis and its impact on Armscor
- Highlights of the past and challenges of the future
- Review of the previous financial year

Funding of Armscor and the impact thereof

The transfer payment to Armscor from the Department of Defence was increased by an average annual rate of 5% for the past two years as well as for the current year, which is a decrease in real terms, considering the inflation rate (CPIX) of between 3,8% and 10,1%.

Consequent to the above situation, Armscor's salary increases were not market-related. As a result, the number of resignations and the erosion of technical capabilities have increased.

Erosion of technical capabilities

Armscor is losing key personnel and through this is losing critical capabilities. This is impacting negatively on Armscor's ability to provide quality service to its customers and to meet the set objectives specified in the Service Level Agreement signed between Armscor and the Secretary for Defence.

Rejuvenation of the workforce

As a Corporation we face the challenge of transforming ourselves in a manner that accords with our country's demographic profile. Armscor's ageing and predominantly white workforce makes it imperative for the Corporation to transform and renew its employee profile. However, this corporate objective has been frustrated by inadequate funding. To systematically transform and renew Armscor's workforce, a typical lead time of two or three years is required in order to transfer expertise from a current incumbent to a new appointee who has limited or no experience in the defence-related industry. This entails defining, capturing and transferring the competencies of the current experts to a younger and more representative generation.

It is also vital to retain personnel by offering competitive salaries and meaningful employment. The window of opportunity for the successful transformation and renewal of Armscor's workforce lies in an increased transfer payment.

Chief Executive Officer's report *(continued)*

However, negotiations are under way with the DOD and National Treasury to address this problem, and I am confident that the problem will be resolved in the next financial year.

Restructuring of Armscor

The period under review experienced a further drive towards transformation of Armscor at a strategic level, aimed at speeding up the earlier Cabinet decision to refocus Armscor on its key role as an acquisition organisation of the State. In this connection the Minister of Defence made known to the Armscor Board of Directors the Government's decision to reclassify Armscor as a Schedule 3A Public Entity.

Investigation into a preferred future corporate form and position for Armscor

Following on the completion of the benchmarking investigation into the best possible future corporate form for Armscor as mandated by the Armscor Board of Directors, the outcome of this investigation was presented to the Plenary Defence Staff Council (PDSC) on 15 July 2007 and to the Secretary for Defence on 17 July 2007. The recommendations of the report were accepted as such by both parties. The report contained the following recommendations: That

- Armscor be reclassified as schedule 3A Service Delivery Public Entity upon promulgation of the envisaged new Public Entities Act;
- Armscor remain a schedule 2 Major Public Entity under the present PFMA and subsequently a schedule 3A under the to be promulgated Public Entities Act;
- Armscor be mandated to provide full life cycle support for Category 1 Matériel as well as sanctioned Category 2 Matériel;
- Armscor be allowed to provide acquisition support to other State Departments with the approval of the Minister of Defence.

On 6 December 2007 a presentation was made to the Minister of Defence and he accepted the proposal of the preferred future corporate form for Armscor.

Defence Evaluation and Research Institute (DERI) implementation

Whilst many aspects of the South African defence-related industry (SADRI) started to change in the last ten years, Armscor, although being part of this industry, has largely remained the same. The Government, through the Minister for Defence, directed that Armscor shed its research, development, test and evaluation capabilities and focus only on acquisition and procurement activities. The research, development, test and evaluation capabilities of Armscor, known as Armscor Business, Defence, Peace, Safety and Security (DPSS) presently within the Council for Scientific and Industrial Research (CSIR) and Overberg Test Range (OTB) a division of Denel, are to be consolidated into a new entity that is to be known as the Defence Evaluation and Research Institute (DERI). This DERI will be located in the Department of Science and Technology as a new organisation.

During the period under review the establishment of the DERI was addressed by conducting a desktop study as requested by the Minister of Defence and to make recommendations on the corporate form the DERI should adopt in order to fulfil its support role to the DOD on its strategic research, development, test and evaluation requirements.

The study was completed and the following recommendations were made:

- that the DERI be established as a new public entity under the Minister of Defence;
- that the Ministers of Defence, Public Enterprises and Science and Technology appoint a dedicated Board mandated to establish the DERI;
- that a formal management body, representing current DERI components and departmental stakeholders, be established to plan and coordinate the establishment of the DERI and to coordinate DERI activities in anticipation and preparation of the new entity;
- that, in view of the cost and disruption of a two-phased approach, the DERI be established without interim consolidation under an existing entity;
- that clear intent should be communicated to the staff of DERI components as soon as possible to counter current uncertainty and declining morale.

Chief Executive Officer's report (continued)

The recommendations were presented to various Stakeholders, Directors General, the Armscor Board and the Minister of Defence who finally accepted the recommendations of the study group, except that the DERI report to the Department of Science and Technology (DST), and the added proposals of the Directors General to use a subsidiary of an existing legal entity as a vehicle to establish the DERI while organisational aspects and legislation are finalised. An acting CEO was appointed to take charge of the formation of the DERI during the 2008/09 financial year.

The business units of Armscor Business not forming part of the DERI would be migrated to the transformed Armscor under a new Department, namely Logistics and Matériel Support, during the next financial year, namely:

- Armscor Defence Asset Management Centre (ADAC)
- Defence Matériel Disposal (DMD)
- AB Logistics.

Defence environmental analysis and its impact on Armscor

The annual Department of Defence (DOD) environmental scan, in conjunction with Government's Medium-term Strategic Framework priorities, produced the following issues impacting on Armscor:

- In the absence of any military threat against South Africa and the preponderance of non-military threats to security in the region, the defence function remains relatively low on Government's list of priorities.
- The defence budget and the allocation to Armscor are therefore unlikely to increase and will remain under pressure.
- The improvement of the quality of corporate governance and accountability will remain high priorities.
- The conduct of peace missions in the region and assistance to other government departments as and when required are likely to remain important components of DOD activity for the foreseeable future.

The DOD has nevertheless identified a clear requirement for a dedicated defence evaluation and research organisation, which will include elements currently resident in Armscor Business (Pty) Ltd.

Selective investment in defence technology and the supporting industry will continue as a means of providing key capabilities to the South African National Defence Force (SANDF).

These realities will inevitably impact on Armscor and will be accommodated in Armscor's strategic planning in order to ensure the continued provision of quality service to the Department of Defence.

The annual environmental scan confirmed that focused, committed leadership, the quality of the current workforce, teamwork, robust processes, a positive corporate image and good client relations provide an excellent foundation upon which Armscor can build its future. It also confirmed that the issues identified as giving cause for concern in the previous scan remain valid and have in some cases been exacerbated by developments over the past period. These will have to be monitored and attended to as a matter of urgency. Further reference to the Environmental Analysis is placed under the Directors' Report.

Highlights of the past and challenges of the future

Progress with the Strategic Defence Packages

In December 1999, the South African Cabinet authorised Armscor to contract the Strategic Defence Packages (SDPs) with six international suppliers for the acquisition of frigates, submarines, lead-in fighter trainer aircraft, advanced light fighter aircraft, light utility helicopters and maritime helicopters. In line with this Cabinet decision, contracting for the maritime helicopters was deferred until the acquisition of the frigates had progressed sufficiently. This contract was signed in August 2003.

The Defence Industrial Participation (DIP) obligations connected with the SDPs initially represented a considerable challenge for most obligators and still remains so today. It is the largest ever defence offset obligation with strict conditions for its performance, including fixed and pre-set six monthly performance milestones through to 2012,

Chief Executive Officer's report (continued)

exacting criteria for the activities that qualify as offset credit and strong penalties for non-performance. Significant progress has been made with 83% of the total DIP obligations fulfilled by 31 March 2008. The outstanding 17% is not considered to be at risk.

Submarine Programme

The submarine programme provides for the acquisition of three Class 209 submarines from the German Submarine Consortium (GSC), for the South African Navy.

The first of these vessels, SAS 'Manthatisi, arrived in South Africa on 7 April 2006. During the reporting period work on this programme has progressed well and the second submarine, SAS Charlotte Maxeke, arrived in Simon's Town as a fully operational submarine on 23 April 2007. The third submarine, SAS Queen Modjadji, was contractually handed over to the SA Navy in Kiel on 30 January 2008 after which preparations for its maiden voyage to South Africa commenced.

The DIP obligation of the German Submarine Consortium (GSC) on this programme is R1,12 billion. To date, R997 million or 89% of this obligation has been discharged in the form of work packages, technology transfers or export orders to the benefit of local defence-related companies.

Frigate Programme

The frigate programme entails the acquisition of four (4) MEKO® A-200 frigates from the German Frigate Consortium (GFC), for the South African Navy.

All four frigates are now fully operational and maintenance support contracts have already been concluded both with local and foreign contractors for the platforms as well as the combat suites of the vessels.

The total DIP obligation of this programme is R2,9 billion, split between the German Frigate Consortium (GFC) for the platform (R564 million) and Thales Naval France (TNF) for the combat suite (R2,336 million). To date, R2,09 billion, or 71%, of the total DIP obligation has been discharged in the form of work packages on the frigates, technology transfers and export orders to the benefit of the local defence-related industry.

Light Utility Helicopter Programme

This programme entails the acquisition of thirty light utility helicopters (LUH) for the South African Air Force from Agusta Westland in Italy. During the year under review, seven helicopters were delivered to the SAAF, bringing the total number of helicopters delivered to date to twenty-three.

The total DIP obligation on this programme was R1,2 billion and Agusta succeeded in becoming the first obligator under the SDPs to successfully discharge its full offset obligation within the contractually agreed discharge period which ended on 19 April 2007. In fact, Agusta continues to place orders with the SA defence-related industry in support of the obligation of Agusta Westland on the maritime helicopter.

Advanced Light Fighter Programme

The contract with the BAE Systems/SAAB consortium provides for the supply of twenty-six JAS39 Gripen advanced light fighter aircraft to the SAAF. The aircraft are presently being manufactured by SAAB at their Linköping factory in Sweden.

The first dual seat Gripen completed the initial flight test programme and is scheduled for delivery to SAAF by end March 2008. During February 2008, the SA Military Airworthiness Board issued the Military Type Certificate for the dual seat aircraft, certifying the aircraft as being airworthy. The second dual seat Gripen was delivered to Air Force Base Makhado on schedule in March 2008 for the start of the ground crew training. The delivery plan for the remaining aircraft is unchanged and on schedule, with the entire programme expected to conclude in March 2012.

The DIP obligation of SAAB on this programme is R5 billion, of which R3,8 billion or 75% has been fulfilled to date. This achievement is well in advance (105%) of the planned performance to date. The final contractual milestone is scheduled for 2011.

Lead-In Fighter Trainer Aircraft Programme

This programme provides for the acquisition of twenty-four Hawk lead-in fighter trainer aircraft for the SAAF from BAE Systems in the UK. In terms of the DIP agreement with

Chief Executive Officer's report (continued)

BAE Systems, all twenty-four aircraft are to be assembled locally by Denel Aviation.

By the end of the reporting period twenty-one Hawk aircraft have been delivered to 85 Combat Flying School at Air Force Base Makhado.

The DIP obligation on this programme was R4,3 billion and BAE Systems succeeded in fulfilling this obligation well in advance of the final contractual milestone of April 2009.

Maritime Patrol Helicopter Programme

This programme entails the acquisition of four Super Lynx 300 Mk 64 helicopters from Agusta Westland in the UK. All four helicopters were delivered during July 2007. The helicopters are based at AFB Ysterplaat where they will be flown by SAAF pilots of 22 Squadron and will be deployed to the South African Navy Valour (Meko A200) class frigates performing anti-surface warfare, maritime patrol and search and rescue roles.

In February 2008 the Minister of Defence symbolically handed the maritime patrol helicopter capability over to the Chiefs of the South African Air Force and South African Navy.

The DIP obligation of the maritime patrol helicopters is R553 million, to be completed in March 2010. To date R201 million or 36% has been discharged.

Airbus A400M Heavy-Lift Transport Aircraft

On 28 April 2005, a contract was established with Airbus Military Sociedad Limitada (AMSL) for cooperation by South African Industry with the design and development of the A400M aircraft and for the subsequent supply of eight A400M military strategic heavy lift aircraft to the South African Air Force.

The programme initially progressed very well, with all milestones being achieved on time. However, in October 2007 a formal announcement was issued by AMSL, indicating a six-month delay in the A400M programme with a further six-month risk. To date AMSL has failed to meet the January 2008 critical milestone of A400M first flight, and the first South African aircraft will most likely

be delayed by approximately 12 months.

The Department of Trade and Industry (DTI) will manage the State's interest in the strategic benefit of Industrial Participation to Industry and therefore Armscor's policy in this regard will not be applied. Industrial Participation has been addressed by means of work packages that will be contracted to South African (SA) industry. Management and accounting of the value of this work will be done by DTI. The Department of Public Enterprises has represented the interests of State-owned enterprises during contract negotiations. Airbus Military Sociedad Limitada (AMSL) and individual companies from SA Industry have negotiated the terms and conditions of work packages and contracted with each other for the execution of the packages.

Review of the previous financial year

The objectives that Armscor set for itself in 2004/05 were of such a nature that they could not be completed in one financial year, as mentioned in my previous report. In 2005/06, 2006/07 and in the period under review, Armscor concentrated on finalising these objectives, which included:

- Implementation of the Armscor Acquisition benchmarking study recommendations;
- Further implementation of black economic empowerment;
- Finalisation of the transfer of the Simon's Town Naval Dockyard to Armscor.

Implementation of the Acquisition benchmarking study recommendations

One of the Armscor Management Board's initiatives was to benchmark Armscor's tendering and contracting processes. The objective of this initiative was to streamline the tendering and contracting process and to ensure that it remains as cost effective and timeous as possible, while maintaining the integrity and accountability of the process.

A successful internal project was launched in July 2004 to benchmark Armscor's tendering and contracting process. This benchmarking project was concluded in March 2005, with a number of recommendations that had to be implemented by Armscor, starting in April 2005.

Chief Executive Officer's report (continued)

The period under review addressed all recommendations, including the specification for a new electronic contract management and administration system.

Implementation of black economic empowerment (BEE)

The Minister of Trade and Industry promulgated the Broad Based Black Economic Empowerment (BBBEE) Codes of Good Practice on 9 February 2007 and has provided for a transitional period of one year for implementation on 9 February 2008. The transitional period has since been extended to 31 August 2008.

Armcor has reviewed its BEE Practice and it was approved by the Management Board on 25 February 2008 to incorporate the BBBEE Codes of Good Practice. All personnel who procure on behalf of Armcor are being trained in the new BBBEE Codes of Good Practice. The objective of this BEE training on the BBBEE Codes of Good Practice is to ensure that Armcor personnel in procuring departments assist towards achieving set BEE targets. This training should be completed by the end of May 2008.

The BBBEE Scorecard has seven elements, namely: Ownership, Management Control, Employment Equity, Skills Development, Preferential Procurement, Enterprise Development, and Socio-Economic Development. The intention of introducing all these elements of the BBBEE Scorecard is to ensure that BBBEE is broad-based rather than focusing on ownership only which tends to be narrow-based.

Transfer of the Simon's Town Naval Dockyard to Armcor

The scheduled transfer on 1 April 2007 did not take place due to a court interdict obtained on the eve of the transfer by NEHAWU, one of the unions in the Dockyard, against the transfer of the dockyard to Armcor.

The actual transfer came into effect on 1 September 2007, when Armcor took over the management and control of the Dockyard.

The period between September 2007 and March 2008 was mainly focused on the consolidation of the takeover, development of a short-term business plan incorporating

the reorganisation plan, normalising the administrative arrangements, which included employee registrations with the relevant pension and medical schemes, employee inductions, union engagements and operational reviews.

The 2008/09 reporting period is viewed as the period in which the focus will be on the reorganisation and streamlining of the operation.

Acknowledgements

A special word of thanks and appreciation to the Minister of Defence, Mr MGP Lekota, and his Deputy, Mr ME George, for their guidance and support, as well as to the Secretary for Defence, Mr JB Masilela, and the Chief of the SANDF, General GN Ngwenya, for their invaluable support to Armcor. A word of thanks is directed to the officials of the Department of Defence who were at all times available and willing to assist in operational matters. My congratulations go to the South African defence-related industry for delivering quality defence equipment to our clients in the SANDF.

I am greatly indebted to the Board of Directors of Armcor and my management team together with their staff for their contribution to Armcor's success during the year under review.

Thank you to the late Dr JAJ de Necker, General Manager: Armcor Business, for his dedication and commitment to the organisation. His death was sudden and a great loss for the team. May his soul rest in peace. My thanks also go to Pierre Hoffmann who retired in September 2007.

We look forward to the new fiscal year despite its challenges. I am confident that under the wise and competent leadership of the Board of Directors and the Management Board, these challenges will be turned into opportunities.



HS Thomo
Chief Executive Officer

Management Board



HS Thomo
Chief Executive Officer



NRM Borotho
General Manager
Corporate Affairs



JS Mkwanzzi
Acting General Manager
Acquisition



CJ Hoffmann
General Manager Finance
and Infrastructure
Retired Sept 07



E Hurter
Acting General Manager
Armcor Business



MM Matibe
Acting General Manager
Quality and IT



Dr JAJ de Necker
General Manager
Armcor Business (Pty) Ltd
Deceased Jan 08



TT Goduka
General Manager Dockyard



JG Grobler
Acting General Manager
Finance & Infrastructure



X Magojo
General Manager Human
Resources
resigned with effect
1 Jan 08

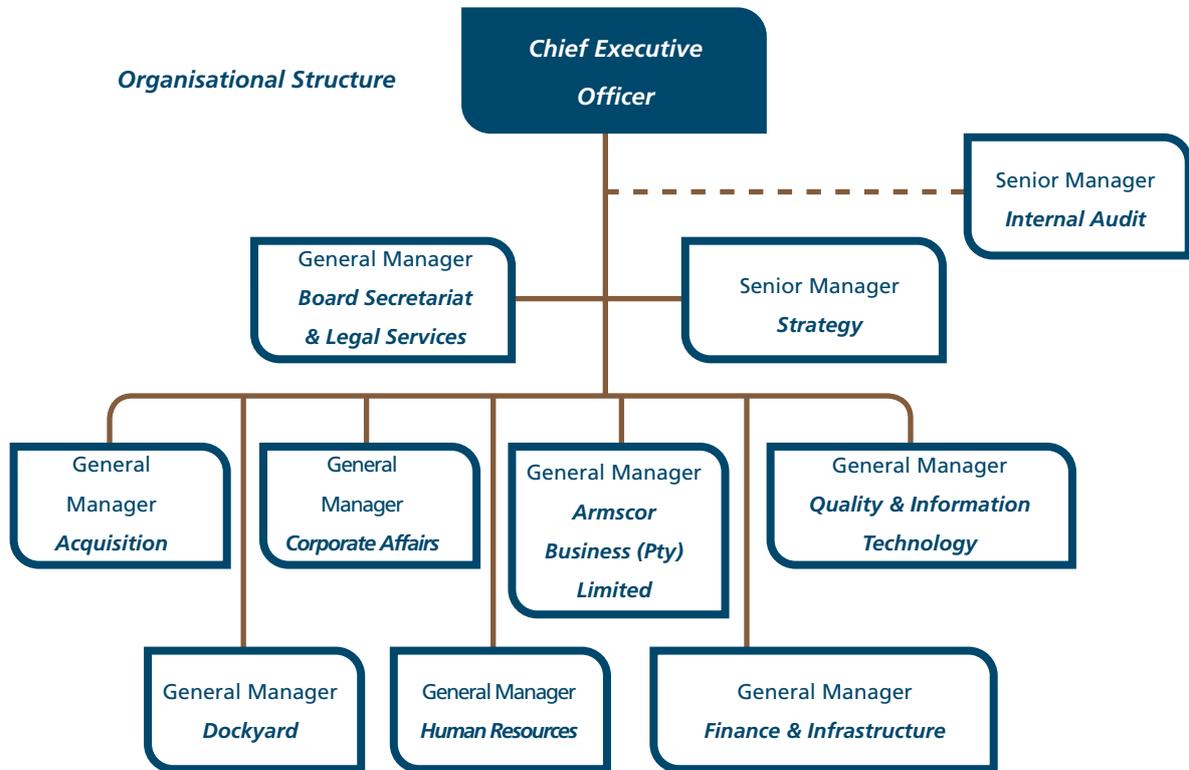


Dr IF Potgieter
Acting General Manager
Human Resources



TN Msomi
General Manager Board
Secretariat and Legal
Services

Review of Operations



FUNCTION

The core function of Armscor is to acquire defence matériel, primarily for the South African National Defence Force (SANDF) but also for other Government departments and services with permission from the Minister of Defence.

The acquisition role of Armscor entails all the actions that need to be taken to satisfy the need for matériel, facilities or services intended for use in or in support of client requirements. This includes long-term operational research, requirement planning, establishment and the management of technology development, design and development of products and systems, and the industrialization and manufacturing of mature products and systems that fully meet the stated user requirements.

Armscor’s acquisition role (Acquisition Business Management) can be broadly divided into four categories, namely System Acquisition Management, Procurement Management, Product Systems Management and Technology Acquisition Management. System Acquisition Management presently represents the bulk of Armscor’s

acquisition function and involves all the activities from the translation of mission and related needs into appropriate technical specifications, to the provision of operationally effective, suitable, survivable and supportable products and systems in accordance with the stated requirements of Armscor’s clients. Procurement Management entails the procurement of existing commercially-off-the-shelf (COTS) or military-off-the-shelf (MOTS) equipment. Products System Management entails the support provided to Armscor’s clients during the operating phase of products and systems and includes the maintenance and logistic support of such products and systems. Technology Acquisition Management entails the contracting for and development of technology in support of future acquisition programmes.

PROCESS

A significant portion of the programme management function within Armscor is centred on the acquisition of complex systems and entails the execution of the System Acquisition Management role. Armscor’s acquisition involvement

Review of Operations (continued)

traditionally starts with the receipt of an approved User Requirement from its client. From there a formalized process of risk reduction is followed, which eventually leads to the contracting of suitable suppliers to develop and manufacture the fully specified products or product systems. A formalized source selection process entailing the development and application of value systems is followed to identify preferred suppliers that would provide the best value for money solutions for providing specific user requirements. In cases where no existing products can meet the specific user requirements, selected suppliers are contracted to develop the required product systems and deliver successive development models. These development models range from experimental development models through advanced development and engineering development models up to pre-production models. After successful evaluation and qualification of the designs and related production processes, contracts are established and managed for the required number of products and product systems.

INTEGRATED PROJECT TEAMS

The proper management of acquisition programmes demands the management of many diverse technical, financial and other disciplines, such as systems and logistics engineering, resource management, contracting, quality assurance and design assurance. At the core of all acquisition programmes are integrated project teams that comprise members from Armscor and the Department of Defence (DOD) with the responsibility to properly and adequately meet all the programme management requirements. Such integrated project teams are led by Armscor programme managers and, depending on the extent and complexity of a programme; various domain specialists are added to the teams to perform specific roles. In order to properly execute their diverse responsibilities, Armscor programme managers not only need to be knowledgeable in their specific technical domains, but also need to be proficient in, for instance, the systems and logistics engineering, commercial and legal fields.

In order to properly execute its professional project management responsibility as required by the Armscor Act, it is essential that the proficiency level of Armscor's programme managers be maintained and continually updated – in all the required domains. In order to achieve this, specific in-house developed training courses and modules have been developed that are focussed specifically

on the competencies required by personnel in the various subdisciplines within the acquisition environment. These training modules, which are mostly computer based, serve both to fast track new programme managers and to act as refresher courses for current programme managers.

STRUCTURE

Armscor's Acquisition Department is functionally structured with technical divisions focussing on specific technical disciplines. The technical divisions thus provide a home base to programme managers specializing in the specific technical domains. In order to improve liaison and interaction with the DOD, Armscor's main client, divisions within the Acquisition Department have been grouped together so as to mirror the structure of the Defence Matériel Division (DefMatDiv) as far as possible. This grouping provides single points of entry to the respective DefMatDiv Directorates and has served to provide significant improvement in communication with the DOD. The Acquisition Department continually strives to improve and streamline its interaction with the DOD and is, as a result of this effort, in the process of developing a new departmental structure in collaboration with DefMatDiv that, once implemented, should fully satisfy the requirements of the DOD in terms of allocation of responsibility and should also ensure optimal employment of the very scarce human resources that are vested in the Acquisition Department.

TECHNOLOGY DEVELOPMENT

The utilization of new technology in the design and development of equipment is important in order to optimize the cost efficiency and effectiveness of new equipment. In order to ensure that the development of new equipment and capabilities for the SANDF is based on the utilization of suitable modern and mature technology, Armscor and the DOD identify and manage a number of technology development programmes within local industry, which are aimed at supporting identified future system development programmes. Armscor programme managers, utilizing their specialist knowledge in the various applicable technological domains, have been very successful in identifying technology building blocks that needed to be matured for eventual implementation in planned development projects. The research into and development of identified critical technologies that are subsequently utilized in the development of new products systems have in the past

Review of Operations (continued)

contributed greatly towards providing the SANDF with competitive advantages in its weapon systems. Involvement in the initiation of new technology development projects remains a very important aspect of the responsibilities of Armscor's programme managers and in order to effectively execute this responsibility it is imperative that the programme managers remain technologically up to date in their specific areas of expertise. It is essential, therefore, that the programme managers gain as much exposure as possible to new developments in the international arena.

STRATEGIC DEFENCE PACKAGES

The strategic defence package (SDP) programmes continue to form a significant part of the acquisition portfolio of Armscor. The period under review saw significant progress on all the SDP programmes, with the conclusion of the foreign part of both the frigate and light utility helicopter programmes. Highlights include the commissioning and handing over to the SA Navy of the last three of the four frigates, delivery and commissioning of the first 16 of the Hawk lead-in fighter trainer aircraft to 85 Combat Flying School at Air Force Base Makhado, the arrival in South Africa of the first South African JAS39 Gripen advanced light fighter aircraft for commencement of flight trials at the Test Flight and Development Centre at Overberg, and the successful first flight of the Westland Super Lynx 300 Mk 64 maritime patrol helicopter.

During the review period, the project office for the acquisition of the Airbus A400M strategic heavy lift transport aircraft was established in Toulouse, France. This programme is already bearing fruit with the participation of local industry in the development and manufacturing of selected components for all aircraft of this type.

ACQUISITION OBJECTIVES

Armscor is still suffering from a lack of capacity to manage all the current programmes to the depth that is required by the DOD's acquisition policy. However, the initiatives of the Armscor Acquisition Department are progressing well to refocus its resources towards adding more technical value in the relevant integrated project teams.

Formalized baseline management on all acquisition projects is delivering very positive results. This initiative, which forms part of the drive to re-emphasise technical

assurance management as part of the acquisition function, is producing benefits in terms of exposing project risks and integration issues and has led to the introduction of several measures to strengthen the capability of integrated project teams on ground level.

Other initiatives launched by the Acquisition Department, showing good progress, are the further development of the capability management process and its integration with the acquisition business register, as well as the development, testing and initial implementation of a work authorisation system. These initiatives are currently being extended to establishing formal job descriptions for all personnel, updating all internal policies and practices, and establishing a comprehensive knowledge base and personnel development system.

SERVICE LEVEL AGREEMENT (SLA) WITH THE DOD

In order to ensure that the acquisition function performed for the DOD is executed in a properly structured, transparent and accountable manner, a rolling three-year service level agreement between Armscor and the DOD has been developed, approved and implemented. Quarterly reporting to the DOD takes place in terms of this service level agreement.

This SLA has been updated to more fully address the service descriptions and detailed definitions of the various tasks performed by Armscor for the DOD in terms of the SLA. A detailed business plan has been incorporated and more accurate and valid performance measures have been defined and incorporated. This updated SLA has been reviewed and accepted within Armscor and is currently being assessed by the DOD prior to final update and approval by the two parties.

Review of Operations (continued)



Type Meko®A-200 Patrol Frigate



Class 209 Mod 1400 Submarine



Rooivalk Attack Helicopter

ACQUISITION HIGHLIGHTS

Maritime Systems

Type MEKO®A-200 Patrol Frigates

The acquisition programme of the four frigates is approaching completion. All four frigates have basically completed their periods of operational test and evaluation, some of which took place in international waters while participating in extensive naval exercises with other foreign navies. The frigates are now fully operational in the SA Navy. Emphasis is currently on the placement of multi-year contracts with the local industry for the maintenance and support of these vessels. The programme will for all practical purposes be completed by the end of 2008 after all the logistic and technical documentation matters have been duly addressed.

Class 209 Mod 1400 Submarines

The acquisition programme has progressed reasonably well during the review period. The second of the three submarines, SAS Charlotte Maxeke, which was named and commissioned in the Nordseewerke Shipyard in Emden on 14 March 2007, arrived in Simon's Town as a fully operational submarine on 23 April 2007. She is presently being put through her paces during an extended period of operational test and evaluation. This submarine also participated successfully with the SA Navy's frigates in a naval exercise in local waters with a number of naval vessels from the German Navy in March 2008.

The third submarine, SAS Queen Modjadji, was named in the Nordseewerke Shipyard in Emden, Germany, on 14 March 2007 and completed her sea acceptance trials in German and Norwegian waters during January 2008. She was handed over contractually by the German Submarine Consortium on 30 January 2008, after which sea training of the SA Navy crew of submarine commenced. This submarine will set sail from Germany on her maiden voyage to the Republic of South Africa on 02 April 2008, accompanied by SAS Protea, the hydrographic survey ship of the SA Navy. She is expected to arrive in Simon's Town on 22 May 2008 and will be commissioned on arrival.

Airborne Systems

Rooivalk Attack Helicopter

The Rooivalk Attack Helicopter Programme has completed all the development work required to achieve the deployment baseline which is required to place the helicopter into service. At the end of the reporting period the first prototype Rooivalk helicopter configured to the deployment baseline was ready to commence with the Release to Operational Test and Evaluation (ROTE) trials which will be conducted by the South African Air Force. After completion of the ROTE trials and the resulting Interim Type Certification of the baseline Rooivalk, the first batch of four helicopters will be retrofitted to the Deployment Baseline standard and delivery of these four helicopters to 16 Squadron Bloemfontein is planned for October 2008.

Review of Operations (continued)



Maritime Patrol Helicopter

Maritime Patrol Helicopter

The Maritime Patrol Helicopter Programme entails the acquisition of four Super Lynx 300 helicopters from Agusta Westland in the UK. All four helicopters were delivered in July 2007, after which final acceptance tests on the helicopters commenced. The helicopters are based at SAAF Air Force Base Ysterplaat where they will be flown by SAAF pilots of 22 Squadron and will be deployed on the South African Navy Valour (Meko A200SAN) class frigates performing anti-surface warfare, maritime patrol and SAR roles.

In February 2008 the Minister of Defence handed the maritime helicopter capability over to both the Chief of the SA Air Force and Chief of the SA Navy. The Minister emphasized the cooperative nature of maritime operations where the Naval frigate and the Air Force helicopter will be forming an organic partnership.

Light Utility Helicopters

The Light Utility Helicopter Programme entails the acquisition of thirty Agusta A109 light utility helicopters from Agusta Westland in Italy. At the end of the reporting period, twenty-three of the thirty helicopters ordered have been delivered to the SAAF. Seven of these helicopters, including the first helicopter to be delivered with floatation gear installed, were delivered during the year under review.

During the course of the programme the SAAF requested that a retrofit be done to all the helicopters to enhance ship-deck landing and stowage capability. During the



Light Utility Helicopter



Airbus A 400M

period under review this retrofit was effected on the nine helicopters produced prior to the implementation of this modification. Electronic warfare (EW) and identification of friend or foe (IFF) trials were also successfully concluded during the period under review.

By the end of the review period the SAAF Agusta A109LUH fleet has been deployed to a total of four SAAF Squadrons and has flown more than 4 000 hours.

Airbus A400M Strategic Heavy-Lift Transport Aircraft

On 28 April 2005 a contract was placed with Airbus Military (AMSL) for the design and development of the A400M aircraft and the supply of eight A400M military transport aircraft, associated products and services.

AMSL has met all its contractual milestones from contract signature to milestone 7 in December 2006. Milestone 8, "Start of Final Assembly", was delayed, however, from the contractual completion date of March 2007 to August 2007.

In October 2007 AMSL issued a formal announcement indicating a delay of six months in the A400M programme with a further six-month risk. Following further problems with engine testing and some military systems, the six-month risk is deemed to have a high possibility of materializing. At the end of the review period, AMSL has failed to meet the critical "First Flight" milestone scheduled for January 2008. At present all indications are that the first South African aircraft will be delayed by approximately 12 months.

Review of Operations (continued)



Gripen Light Fighter Aircraft

As part of the offset activities on the A400M programme, Denel and Aerosud have already been allocated significant work packages and it is expected that these companies as well as other RSA companies will be allocated further work packages as Programme Partners for the life of the programme which is currently estimated at 380 aircraft.

Advanced Light Fighter Aircraft

The Advanced Light Fighter Programme entails the acquisition of twenty-six JAS39 Gripen advanced light fighter aircraft from the BAE/SAAB consortium. The aircraft are being manufactured by SAAB at their Linköping factory in Sweden.

After a period of extended flight trials on the first South African Dual Seat Gripen aircraft at the Test Flight and Development Centre at Overberg, the SA Military Airworthiness Board issued the Military Type Certificate for the Gripen Dual Seat aircraft in February 2008, certifying the aircraft airworthy. This first South African aircraft is scheduled for delivery to the SA Air Force by the end of March 2008. The second Gripen aircraft was delivered to Air Force Base Makhado on schedule in February 2008 for the start of ground crew training. The delivery plan for the remaining aircraft is unchanged and on schedule with the entire programme expecting to be concluded in March 2012.

Lead-In Fighter Trainer Aircraft

The Lead-In Fighter Trainer Programme entails the



Hawk 120 Lead-in Fighter Trainer Aircraft

acquisition of twenty-four Hawk 120 aircraft from BAE Systems in the UK. The aim of this programme was to bridge the training gap between the ASTRA Ab Initio trainer aircraft and the Gripen Advanced Light Fighter aircraft. As part of the DIP programme, all twenty-four aircraft are being assembled locally by Denel Aviation.

By the end of the reporting period a total of 21 Hawk aircraft were delivered to 85 Combat Flying School at Air Force Base Makhado. The Flight Test Instrumented (FTI) Hawk aircraft successfully completed the test phase and will be delivered during May 2008 together with the remaining two aircraft.

Two aircraft, painted in the National Livery, were displayed during the SAAF's Air Force day in February 2008.

New Generation Short-Range Air-to-Air Missile

This programme entails the development of the A-Darter short-range air-to-air missile system by Denel, co-funded by the Brazilian Air Force.

During the review period Denel has completed the first year of full-scale development. The past year saw the transition from technology to full-scale engineering development. The "paper design" phase has been completed as planned and many design risks have been addressed and reduced to such an extent that the "proof-of-design" phase can commence, after which an iterative process of building hardware, test and evaluate, analysis of test results, change/update design, re-build and re-test will follow. This interactive process

Review of Operations *(continued)*



GBADS (Ground Based Air Defence System)

will finally result in system qualification scheduled for the first quarter of 2012.

The co-operation between Armscor and the Brazilian Air Force, in operation since August 2006, has been solidified into a successful co-operative working relationship, to such an extent that new ventures are being seriously considered by decision makers of Brazil, based on the A-Darter development programme management model.

Landward Systems

Ground Based Air Defence System (GBADS) for the SA Army

The contract placed with Denel for the development and delivery of the Local Warning Segment (LWS) of the new Ground Based Air Defence System (GBADS) has experienced further slippage of six months due to the technical problems experienced with the communications functional element. This additional delay in the programme has caused the planned final completion date to move to May 2010.

During the reporting period the technical issues with the communications element have been resolved and integration of all the functional elements has commenced. Thus far the integration effort has progressed without any major problems.

New-Generation Infantry Combat Vehicle

This project will provide a complete New Generation



NGICV-PS Infantry Combat Vehicle

Infantry Combat Vehicle Products System (NGICV-PS) to replace the Ratel infantry combat vehicle that has been in service since 1976.

The contract for the NGICV-PS was concluded with Denel Land Systems as prime contractor on 21 May 2007 and makes provision for the acquisition of the prime mission equipment in two phases, namely:

Development Phase which entails the design, manufacture, delivery and evaluation of the five Engineering Development Models (EDM) representing the five required Combat Variants including their respective logistic support, ammunition and training simulators; and

Manufacturing Phase which entails firstly the industrialization of 12 Pre-Production Models representing the five Combat Variants including their respective logistic support, ammunition and training simulators, and subsequently the production of 247 Combat Variants including their respective logistic support, ammunition and training simulators.

This project has a local content in excess of 60% without taking the direct Defence Industrial Participation commitments of foreign subcontractors into account. This project will thus provide a huge financial boost for the local defence industry.

Denel Land Systems and its subcontractors have conformed to all contractual delivery requirements for the period ending 29 February 2008. The mock-up

Review of Operations (continued)

of the vehicle platform was accepted by Armscor in February 2008 and the five EDM platforms required for the development phase of the programme are already being manufactured by Patria Vehicles in Finland with a planned completion date of December 2008.

Common Weapon Systems

New Generation Tactical Communication System

The concept design for a new generation tactical communication system has been completed successfully. This concept design provided for a complete technical architecture, definition of the subsystems as well as the specification of subsystems. The communication system will make provision for state-of-the-art transmission and information security techniques, whilst incorporating semi real time data link performance characteristics as well as digital voice communication. Backwards compatibility to existing systems will be possible, utilizing an advanced management system.

Interoperability between all elements of the battlefield (SA Air Force, SA Army, SA Navy, etc) will be possible without making use of gateways or protocol converters – the first system in the world capable of total interoperability.

Based on the initial specifications, a number of advanced technology demonstrators have been developed to test and verify the technical concepts. These technology demonstrators will form the baseline for future development.

The communication system will consist of seven subsystems, which will be contracted separately. The first request for proposal will be published in April 2008 and it is envisaged to complete development during the 2012/13 financial year. Almost the entire system will be developed and manufactured locally, which will provide for retention and creation of new jobs in the skilled as well as semi-skilled sectors of industry – supporting the government's drive towards growth.

Technology Development

During the period under review Armscor, in close collaboration with the DOD, continued with the long-

term technology development programme of the Defence Research and Development Board (DRDB) of the DOD. This programme endeavours to sustain a ready technology base in the local defence-related industry (DRI) through the development and retention of strategically essential technologies, as set out in the White Paper on Defence Related Industries.

Ongoing research and development under this programme covers a wide spectrum of capabilities in all sectors of the DRI – including Landwards, Maritime, Airwards, Electronics and Soldier Support technologies. A major portion of the DRDB programme budget is still dedicated to the funding of the various Defence Evaluation and Research Institutes that are located in Armscor Business, Denel and the CSIR, by means of several contracts placed with these organisations by Armscor.

Examples of ongoing research that is planned to be absorbed in future equipment acquisition projects include the following:

- improved protection of soldiers against landmine blasts;
- the development of insensitive munitions (i.e. ammunition with low vulnerability to unintended detonation);
- evaluation of the locally developed hybrid diesel-electric drive combat vehicle;
- platform-protection systems for aircraft and ships (attack warning systems, decoys, countermeasures);
- improved performance of ship-mounted radars;
- information warfare (e.g. protecting computer systems against cyber-attacks);
- secure communications;
- defence against chemical warfare (including toxic industrial chemicals);
- soldier endurance and performance characterisation;
- unmanned air vehicles and autonomous under-water vehicles.

Review of Operations (continued)

Of particular interest are various technologies developed for the SA Military Health Services for the mass decontamination of soldiers exposed to hazardous chemical attacks, which are now being considered for use by emergency services during the 2010 Soccer World Cup events.

DEFENCE INDUSTRIAL PARTICIPATION

An important part of the SANDF objective of maintaining a critical minimum state of preparedness is the existence of an equally prepared and capable local defence industry.

Defence Industrial Participation (DIP) is an integral part of the DOD policy framework for the retention and development of the South African Defence Industry, which is regarded as a nationally strategic and economic asset.

DIP contributes significantly to the retention of self-sufficiency in key areas, the establishment of life cycle support of sophisticated equipment, the earning of foreign exchange through exports, the creation of domestic employment and the development of defence technology.

Where the Department of Trade and Industry (DTI) through

its National Industrial Participation (NIP) programme aims to grow and develop various economic sectors, DIP complements this process by specifically focusing on the defence industry.

Armcor manages the following portfolios under the DIP programme:

- Strategic Defence Packages (SDPs) Portfolio addresses the DIP obligation resulting from the acquisition of Strategic Defence Packages signed in 1999.
- Active Portfolio addresses the DIP obligations resulting from all new procurements by the Department of Defence with an imported content equal to or higher than USD 2 million.
- Pro-active Portfolio addresses all the pre-emptive agreements with foreign companies whereby credits are banked in anticipation of future defence purchases by the South African Government.
- Police Contracts Portfolio addresses DIP obligations resulting from all procurement of the Police Service directed through Armcor.

The status of the four DIP portfolios at 31 March 2008 is as follows:

Portfolio	Number of running contracts	Number of completed contracts	Total obligation Rm	Credits passed during current financial year Rm	Total credits passed to date: Rm
SDPs	7	2	15 111	1 088	12 506
Active	8	19	5 354	320	5 198
Pro-active	12	22	-	7	590
Police contracts	2	1	118	0	80
TOTAL			20 583	1 415	18 374

DIP Status of the Strategic Defence Packages at 31 March 2008

Project	Obligation Rm	Planned performance Rm	Actual performance Rm	Actual vs planned %	Actual vs Obligation %	Sales (local and export) Rm	Technology Transfer Rm	Investments Rm
Frigates	2 941	2 274	2 085	92	71	1 539	521	25
Submarines	1 121	877	997	114	89	752	237	8
Light utility helicopters	1 194	1 194	1 194	100	100	675	487	32
Hawk aircraft	4 252	3 978	4 265	107	100	3 275	973	17

Review of Operations (continued)

<i>Project</i>	<i>Obligation</i>	<i>Planned performance</i>	<i>Actual performance</i>	<i>Actual vs planned</i>	<i>Actual vs Obligation</i>	<i>Sales (local and export)</i>	<i>Technology Transfer</i>	<i>Investments</i>
	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>%</i>	<i>%</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Gripen aircraft	5 050	3 241	3 764	116	75	1 767	1 825	172
Maritime helicopters	553	251	201	80	36	170	29	2
Total	15 111	11 815	12 506	106	83	8 178	4 072	256

The outstanding obligations currently present a low risk of non-achievement as they are all covered by sufficient and viable planned activities.

Approximately 25 BEE companies are currently involved in the DIP programme and are at different stages of becoming part of international supply chains. Included in the actual performance to date, are DIP credits to the value of ± R141 million awarded for contracts placed with some of these BEE companies.

Highlights of some of the DIP activities credited during the period under review:

Frigates

The Frigate DIP obligation is divided into two programmes. The German Frigate Consortium (GFC) is responsible for the Platform obligation and Thales Naval France (TNF) for the Combat Suite.

The GFC has completed 95% of its obligation and to maximise the benefit to the local defence-related industry, extension was granted to March 2009 for the remaining 5%. The extension relates to one specific activity in progress of which the export orders are placed slower and later than anticipated, but the materialisation thereof is not considered to be at risk.

Although TNF has only discharged 65% of the Combat Suite obligation, it is in line with the planned performance and the final milestone is only in March 2010. Sufficient activities have been identified and planned to cover this outstanding portion of the obligation.

Submarines

A major achievement in the reporting period was the

full and final completion on the Indirect DIP activities which do not directly relate to the acquisition of the submarines. These activities represent 52% of the total obligation and in most instances fell outside the Obligor's core business.

The outstanding 11% balance of the obligation relates to Technology Transfer aimed at the establishment of a strategic capability for the life cycle support of the submarine combat suite. Due to the availability of the submarines, the required work will only be completed in 2009 and the GSC was therefore granted an extension to March 2009 to finalise this activity.

Maritime Helicopters

With delivery of the aircraft in July 2007, it is appropriate to note that a number of on-board systems were provided by South African companies. Other planned DIP activities focus on the life cycle support of the helicopters.

Light Utility Helicopter

The alliance created through the DIP programme with AgustaWestland, for the supply of the LUH 109 helicopters to the SAAF, has established Saab Denel as an integral part of the Augusta Westland supply chain and has resulted, after completion of the Agusta DIP obligation in February 2007, in a major contract between the two companies for future cooperation in the aeronautical field.

Hawk Aircraft

BAE Systems succeeded in completing its contractual DIP obligation one year in advance of the contractual completion date.

Review of Operations (continued)

BAE Systems continue to place further orders with the defence-related industry for various products, thereby demonstrating the long-term relations that have been established with the industry, as intended by the DIP programme.

Gripen Aircraft

Saab has already completed 75% of its DIP obligation, which is 116% of the April 2008 milestone. Saab is thus well ahead of meeting its DIP obligation by the contractual due date of 2011.

The technology transfer plan to enhance the Design and Development Centre, which was established at Denel Aviation as part of Saab AB's DIP obligation, has been completed. Due to the financial constraints of the DOD, this facility remains under-utilised and marketing of the capabilities and capacity to foreign entities is also proving to be difficult due to the highly classified nature of the work that can be undertaken.

Negotiations to further enhance the capabilities of SAAF test flight centre at Bredasdorp is nearly complete, in terms of which Saab will leave all the test equipment, hardware and software brought from Sweden for the flight test of the South African Gripen at the centre for further use by the SAAF, in lieu of DIP credits.

Active Portfolio

New Infantry Combat Fighting Vehicle (Project Hoefyster)

With the contracting of Denel to supply and deliver new infantry combat fighting vehicles, the company Patria, as a subcontractor to Denel, attracted a DIP obligation for Phase 1 to the value of R288 million. This obligation was successfully fulfilled through the export of Umkhonto missiles manufactured by Denel, to the Finnish Navy.

BEE

The BEE Practice was updated and approved by the Management Board on 25 February 2008 to incorporate the BBBEE Codes of Good Practice which were promulgated by the Minister of Trade and Industry on 9 February 2007.

The Minister has since extended the implementation date to 31 August 2008.

BEE Spending Analysis (2007/08)

Operating budget	Total expenditure	Target	Actual
Percentage	100%	50%	59.43%
Amount	R36,756,462	R18,378,231	R21,845,998
Acquisition	Total expenditure	Target	Actual
Percentage	100%	25%	26.28%
Amount	R1,169,421,731	R292,355,433	R307,324,031

QUALITY

Acquisition Quality

Quality Assurance (QA) continues to provide support on acquisition programmes to ensure that programme objectives are met and quality products are supplied to the SANDF.

On the strategic defence programmes, QA continued to be actively involved in the development, production, acceptance and delivery of aircraft and naval product systems and logistic support products, and also conducted initial product support QA audits on the aircraft systems already in service. The following strategic defence systems were accepted by Armscor QA for delivery to the SANDF during the period under review:

Five (5) Hawk MK 120 aircraft

Seven (7) Agusta A109 light utility helicopters (LUHs)

Four (4) Super Lynx 300 helicopters

One (1) Type 209 submarine.

Interim Product Support Supplier (PSS) audits were also conducted in the Lynx, Hawk and LUH operational environment. QA also continued to provide quality engineering support to the Acquisition Department through the performance of contractor source selection process assurance activities and baseline audits, to provide inputs to the various Armscor and DOD approval forums. In this regard process assurance was performed on 71 orders and 35 baseline audits were conducted.

Review of Operations (continued)

Industry Quality Audits

Audits were carried out on 277 new contractors to ensure that they are compliant with Armscor requirements before contracts can be placed with them. The target is to conduct the audit within one month of receiving such a request.

In addition, Armscor continuously measures the performance of contractors. In this regard, 130 mature contractors were measured and the average performance for the year was 87,77 against a performance target of 85. The 11 immature contractors who were assessed measured 78,96 using the same measurement method and target.

OTHER FUNCTIONS AND ACTIVITIES

Information Technology Infrastructure

The Server Consolidation Project, which was a subproject of the IT Infrastructure Renewal Project, was completed successfully. As planned, Armscor ICT managed – through this project – to consolidate its large number of servers at Head Office onto one single Egenera Blade Frame server technology. The project reduced the number of physical servers at Armscor from 110 to 38 with concomitant savings on electricity, air-conditioning, space and costs. The first phase of the Thin Client Deployment subproject was also completed successfully. Thin Client devices are now rolled out on a per case basis. The current network infrastructure no longer complies with business requirements and has also reached end of life. The replacement of the network is in progress and will be completed by June 2008.

Armscor took a decision to revert to the model of owning its own computer assets instead of renting them. ICT Division embarked on a project to phase out all rented equipment and to replace it with own equipment. This project has been completed, except for some network equipment that will still be rented until June 2008.

The project to re-engineer the application systems of Armscor is still on hold as no funds were made available for this project during the financial year. ICT Division is actively evaluating other options in order to reduce the capital required, and the funding requirement will again be tabled at the appropriate forums in the new financial year.

ISO 9001: 2000 Certification

In order to ensure good Corporate Governance, eight

internal quality audits were conducted during the financial year in accordance with the three-year audit plan, with no major findings reported. Three of the audits were conducted in Acquisition Divisions, three in Quality Assurance Divisions and one each in the Defence Industrial Participation and Foreign Liaison Divisions.

Two audits were also conducted by the South African Bureau of Standards (SABS). No findings were reported and Armscor's certification status as an ISO 9001: 2000 service provider was confirmed.

DOCKYARD

Transformation

The transfer process of the Naval Dockyard Simon's Town was initiated by the Minister of Defence in 2001. This process resulted in a number of studies which looked at the most appropriate structure to transfer the Dockyard into. The outcome of these studies resulted in the Ministerial approval for the Dockyard to be transferred to Armscor as a subsidiary of Armscor.

Agreements were established, namely the Dockyard Transfer Agreement and the Service Delivery Agreement. The agreements govern the relationship and management of the Dockyard, respectively between the Department of Defence and Armscor. They were supported by the Human Resources Agreement, which focused on the personnel transfer aspects and the most suitable transfer vehicle in terms of legislation.

Mandate

The Dockyard is the SA Navy's maintenance repair authority responsible for the upkeep of the SA Navy fleet. This is more critical at this stage, especially in the light of the recently acquired state-of-the-art surface ships and submarines.

The Dockyard also boasts a state-of-the-art drydock facility, which is one of few highly sought after facilities in Southern Africa.

The primary mandate is to ensure that the Dockyard is transformed into an efficient, effective and an economically viable operation for fleet maintenance support to the SA Navy, whilst the secondary mandate is to utilise spare capacity and exploit commercial opportunities to the fullest.

Review of Operations *(continued)*



Dockyard Personnel

Transfer Highlights

The Dockyard was finally transferred to Armscor from the Department of Defence on 1 September 2007. The scheduled transfer on 1 April 2007 did not take place as a result of a court interdict obtained on the eve of the transfer by NEHAWU, one of the unions in the Dockyard. The key issues related to administrative issues, but the Labour Court cleared for the transfer to proceed.

A formal briefing of Dockyard management, Organised Labour and all Dockyard employees was undertaken by Armscor management during takeover.

The transfer also culminated in a ceremonial handover on 28 September 2007, where the Chief of the South African Navy, Vice Admiral Mudimu, handed the Dockyard over to the CEO of Armscor, Mr Thomo.

Challenges

The period between September 2007 and March 2008 was mainly focused on the consolidation of the takeover, development of a short-term business plan incorporating the reorganisation plan, normalising the administrative arrangements, which included employee registrations with the relevant pension and medical schemes, employee inductions, union engagements and operational reviews.

A number of activities were undertaken during the period under review and are summarised below:

Safety, Health and Environmental Audit

A comprehensive Safety, Health and Environmental (SHE) audit covering the entire premises and scope of



Handover of Dockyard from Chief of SA Navy Vice Admiral Modimu to CEO of Armscor Mr Thomo

the Dockyard was conducted. The requirements of the Occupational Health and Safety Act (Act 85 of 1993) and Regulations as promulgated in accordance with the Act were used as a minimum standard.

This audit identified a number of shortcomings in the Dockyard. An abatement plan has been developed to deal with the issues identified during the audit, which will include the development of a formal SHE management system to ensure full compliance with legislative requirements.

A risk plan was also developed for the Dockyard. A number of risks were identified and are receiving attention.

Commercial

A number of commercial dockings have taken place during this period, including the docking of the Department of Environmental Affairs and Tourism's marine patrol vessels.

A number of commercial entities have shown interest in engaging the Dockyard for entering into some partnership arrangements, which would result in the rejuvenation of the Dockyard. These initiatives are being monitored.

Operational Service Level Agreement

An operational Service Level Agreement (SLA) between the Dockyard and the SA Navy Fleet organisation has been developed and is undergoing its own approval process. The purpose of this SLA is to regulate and monitor the services of the Dockyard, thus ensuring the delivery of services as envisaged by the SA Navy as the primary Dockyard customer. It is envisaged that this SLA will be effective during the 2008 review period.

Review of Operations (continued)

FOCUS AREAS

The 2008/09 period is seen as the critical stabilisation and reorganization phase, in which a number of activities will be undertaken to establish an efficient, effective and an economically viable operation. These activities include the development of a facilities and asset transfer plan, the rollout of the reorganisation plan and the development of a marketing plan. The reorganisation plan includes development of the organisation structure, staff and management appointments.

ARMSCOR BUSINESS (PTY) LIMITED

Armcor Business (Pty) Ltd is a wholly owned subsidiary of Armcor and is mandated to manage, support and maintain the strategic facilities and essential Defence industrial capabilities, resources and technologies as identified by the Department of Defence.

It must also maintain such special capabilities and facilities that are regarded by Armcor not to be commercially viable, but may be required by the Department of Defence for security or strategic reasons. Armcor Business also provides defence operational research, management of technology projects as required by the Department of Defence and supplies a defence engineering and technical capability to the DOD and Armcor.

Armcor Business may exploit such commercial opportunities as may arise out of Armcor's duty to acquire defence matériel or to manage technology projects.

ESTABLISHMENT OF A NATIONAL DEFENCE EVALUATION AND RESEARCH INSTITUTE (DERI)

The Minister of Defence approved the formation of a DERI as a new public entity which will report to the Minister of Science and Technology and have its own Board of Directors and CEO.

The following entities will form the DERI:

- Armcor Business (Pty) Ltd – a subsidiary of Armcor
- Defence Peace, Safety and Security (DPSS) – a division of the CSIR
- Overberg Test Range – a division of Denel.

Compelling reasons for establishing a DERI

Establishing a DERI is necessary for the following reasons:

- To establish a dedicated defence research, development, test and evaluation (RDT&E) capability that will be able to understand complex defence systems and provide innovative solutions.
- To maintain current capabilities identified as strategic and grow new ones in a sustainable way.
- To ensure that strategic defence RDT&E capabilities and facilities are sustainable, well funded and used effectively.
- To achieve an optimal return on defence investment in Research and Development.
- To be able to enjoy the benefits of managing the distributed defence research capabilities as a single system.

The challenge will be to move to a new dispensation where the State-owned defence, science, research, test and evaluation technology entities are consolidated, made sustainable and given a new vision aligned with national defence and security. The other challenge facing Armcor Business RDT&E facilities is to rejuvenate the ageing knowledge workforce.

GEROTEK TEST FACILITIES

The mandate and strategic intent of Gerotek Test Facilities is firstly to support Armcor and the DOD in the acquisition process and secondly to render services to the commercial sector locally and abroad. Gerotek Testing Services provides essential testing services to ensure that components, products or vehicles purchased conform to the specifications set by Armcor and the military. Gerotek Events provides a platform from where these products and services are introduced to the marketplace, and Gerotek Training provides essential driver training services to ensure that the vehicles are used in a safe and controlled manner. Sidibane restaurant and conference facility provides support to all the business units at Gerotek in order to provide a one stop service to its clients.

Review of Operations *(continued)*



Gerotek test Facilities

Several highlights were experienced during the year, the following of which are worth mentioning. Gerotek Testing Services maintained its ISO/IEC 17025 accreditation status as well as its expertise and skills which is essential for service delivery to comply with the Service Level Agreement (SLA) requirements. Various capital plan activities were started and are either completed or in progress. Amongst these are the construction of an open area test site (OATS) for electromagnetic compatibility (EMC) testing, the establishment of an endurance test workshop, and the procurement of two new climatic test chambers. At the Paardefontein Antenna Test Range a standby power supply unit is being procured to counter the negative effects of load shedding on service delivery.

Commercial activities were much more prominent during the year, with local and international clients being accommodated. These commercial activities contributed extensively to the better than expected financial results and the most notable of these were DaimlerChrysler, Bell Equipment, Tata, Mahindra and BAE Systems.

Gerotek Events hosted several military, commercial and corporate events. Demand for vehicle promotional events increased substantially during the past year and the annual Car of the Year competition evaluation process took place at Gerotek. Major launches and Ride-and Drives have been hosted for BMW, Mini, General Motors, Toyota, Subaru and International, to mention but a few.

Gerotek Training maintained its Transport Education Training Authority (TETA) accreditation. Two major professional driver training learnership programmes have been completed.



Set up for an Ammunition Fast Cook off Test

Training has also been conducted for representatives from the Senegal military and for a mining group in Angola and the Democratic Republic of the Congo (DRC). The mining, motor, truck and bus industries have made extensive use of Gerotek Training. Amongst these were 4-Rings Audi driving experience, Landrover experience, Toyota advanced driving, Driving Dynamics (General Motors), Volkswagen Academy, Harley Davidson and Honda driver training. This contributes to the total impact that Gerotek has on the upliftment of driver training skills in South Africa.

The SABS/SASETA/POLICE accredited small firearms training facility maintained its accreditation and expanded its market during the 2007/08 financial year.

Some of the main challenges facing Gerotek Test Facilities are the ageing of the test tracks and equipment, the loss of key personnel and the rising transportation cost for international clients to transport testing vehicles and components to South Africa.

ALKANTPAN TEST RANGE

Alkantpan's mandate and strategic intent is to ensure a quality and sustainable weapon and ammunition test service to the RSA Armaments Industry, of which the DOD and Denel are the major role players, as well as international clients. Through this intent Alkantpan should be the ultimate choice for ballistic and other munitions testing.

One of numerous highlights at Alkantpan was the extension of services to include high-definition high-speed video photography as well as tracking radar capability for

Review of Operations (continued)

all standard ballistic tests. These added services ensure that the client is able to observe in real time the behaviour of the product, lending itself to a reduction in the overall project timescales.

Alkantpan fulfils the requirement for a safer and environmentally friendly industry through focussing on surveillance, environmental and insensitive munitions tests. These tests enable the manufacturer and user to do proper hazard classification and risk assessments on the storage, transportation and usage of the product. Alkantpan has accepted the challenge to incorporate these tests in the conventional artillery, armour, mortar and short-range missile tests.

Tests conducted for foreign clients contributed to Alkantpan's skills development and experience gained, as well as to financial gains in order to maintain the capital intensive facility.

An Integrated Business Management approach (maintaining ISO 9001 certification, working towards ISO 14001 certification and accreditation as a SANAS Inspection Authority) are beacons of value and trust to clients and contributes to Alkantpan's vision to be the ultimate choice for ballistic and other munitions testing.

To ensure ecologically sustainable development and assistance with the careful utilisation of natural resources, a close relationship is maintained with the Northern Cape Government's Department of Tourism, Environment and Conservation and Department of Agriculture. A number of oryx and springbuck were donated to the Department of Tourism, Environment and Conservation for two of their communal wildlife projects which are part of the translocation of the Platfontein and Schmidtsdrift communities. This donation is regarded as a highlight in Alkantpan's numerous actions towards social upliftment in the community.

One of the main challenges facing Alkantpan is the ageing workforce and not only the replacement with a balanced and demographically representative young workforce but finding the necessary expertise willing to relocate to this remote area.

Transportation issues and costs regarding weapons and ammunition remains a challenge to Alkantpan and its

international clients. Meetings are held on a high level with Transnet Management to resolve these issues.

A need exists to accelerate Alkantpan's capital expenditure plan in order to address strategic goals, client requirements and queries as well as to comply with new explosives and safety, health and environmental (SHE) legislation.

INSTITUTE FOR MARITIME TECHNOLOGY (IMT)

IMT strives to meet the South African Navy's (SA Navy) present and future needs in scientific and technical system support and real-time naval operational solutions, including the maintenance of strategic capabilities. IMT also provides scientific and technical support services to the broader Department of Defence as well as to regional maritime communities. IMT utilizes commercial opportunities which arise from IMT's business and renders techno-military expertise in the areas of Environmental Assessment, Above Water Sensors and Signatures, Underwater Sensors and Signatures, Naval Systems Subsurface, Naval Systems Above Water, Underwater Security, Maritime Knowledge Dynamics and Integrated Signature Management. IMT's location in Simon's Town enables it to offer unique services.

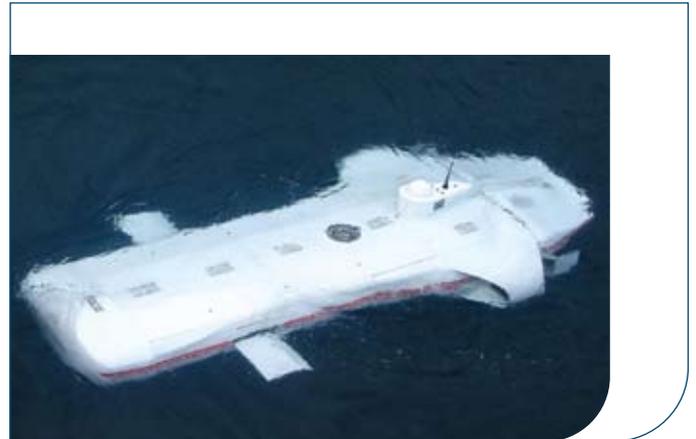
During the year under review IMT continued to render the under-mentioned services of a high standard and to the satisfaction of its clients and principals.

- All four the SA Navy frigate sonars that were acquired have been accepted using the locally IMT developed portable sonar target (PSTAR) from the IMT vessel (SEALAB) during the sea acceptance trials.
- IMT also assisted the SA Navy and the SITRON Joint Project Team during trials involving electronic warfare equipment onboard the new frigates.
- Acoustic data collected at a German sound range were analysed by IMT and used to verify the contractual acoustic sea acceptance tests of all three submarines. IMT also supported the degaussing effort on all three submarines on the degaussing range in Germany.
- In the process of knowledge transfer from IMT to SA Navy personnel, a total of nine (9) IMT Integrated Maritime Technology Demonstrators (IMTD) were delivered to the SA Navy for evaluation. The IMTD supports naval

Review of Operations *(continued)*

subject learning, limited databases and limited sensor performance prediction and acoustic data recording. Upgraded training material, models, handbooks and databases are added to the IMTD annually. IMT started with the development of an acoustic trainer for submariners to help them with training in passive sonar target classification. Work also continued in expanding the offshore-based sonar database.

- Particular progress was made with the concept of organic mine countermeasures, demonstrating that a surface ship can obtain a sonar picture of the sea bottom ahead of the ship by deploying a remote sonar platform.
- As part of the support to the Navy with the torpedo weapons system, IMT performed a series of evaluation tests on shelf-life-expired primary batteries for the weapon. This resulted in the re-classification of the batteries for operational use, thereby reducing the acquisition requirement for these very expensive batteries.
- The Autonomous Underwater Vehicle (AUV) demonstrator, fitted with a video camera on a periscope, has completed successful optical surveillance trials. Trials were performed with the AUV transmitting the video data in real time back to the base station through an antenna mounted on the periscope.
- A baseline was established for the submarine warfare simulation environment. This simulation environment was used to evaluate the current torpedo countermeasure tactics of SA Navy submarines.
- IMT has been performing the programme management function for a technology demonstrator programme on an active off-board decoy in an effort to demonstrate technological capability in the South African industry, universities and defence research institutes in preparation of defining the requirements for such a system. Selected industry partners are contracted to expand their existing technology base in the direction of a demonstrator system as defined by IMT under guidance of the SA Navy.
- IMT – together with the SA Navy, Table Mountain National Parks, University of Cape Town and the Cape



AUV (Autonomous Underwater Vehicle)

Metropolitan Council – once again hosted a most successful public feedback session for residents and interested persons on environmental health of the ocean and other similar topics involving Simon's Town.

- IMT assisted with the Sea Acceptance Trials (SATS) of the Multi-Influence Range (MIR) being acquired by the SA Navy. The operational commitments of the SA Navy were limited to availability of range deployment resources. The IMT work boat (SEALAB) was utilised to do most of the deployment activities. This enhanced IMT's ability to design Standard Operational Procedures, which is a requirement for IMT to support the SA Navy with Acoustic, Pressure and Seismic Signature Management. IMT has subsequently been requested to respond to a Request for Quotation (RFQ) for the ongoing operational support of this range.
- IMT is actively involved in the modelling and analysis of naval combat systems with a view to assisting the SA Navy in optimising its system effectiveness and performance. In this regard, a number of comprehensive simulation and modelling tools have been developed / acquired. This allows for, amongst other things, modelling of ship air defence systems, anti-ship missile countermeasures and torpedo countermeasures.
- IMT is providing the technology leadership and programme management for the continuing research and development of an off board active decoy countermeasures system. This includes the system

Review of Operations (continued)

integration effort, conducting development test and evaluation trials, and establishing subsystem performance requirements. The detailed development of subsystems and components is being undertaken by various industry and institutional parties.

- New geospatial technologies explored during the past years have culminated in achieving a method of display of time-based modelled spatial weather data, not previously possible. This means that a host of modelled synoptic weather parameters – such as wind speed, direction, cloud cover, rainfall, etc – can be displayed as time layers within a Geographic Information System.
- After about two years of preparation, a Memorandum of Understanding was signed between IMT (Armscor Business) as a non-sponsorship member and many other participants of SADCO (Southern African Data Centre for Oceanography). This has formalized the commitment and value of SADCO and the contribution of IMT to this national asset.
- A mechanical autonomous rising buoy invention was proposed during the year. The system is intended to collect data at the seafloor and upon a trigger or timed interval fill a buoy with air from a pressured air cylinder. The buoy attached to a 'motor' spring then rises to the surface, to download its information via an air communications link. Once complete, the air is purged and the buoy sinks to its tethered location on the seafloor again, assisted by the spring. Although it is still in a very early stage of development, initial tests have been encouraging. A patent application has been submitted.
- A combined trial between IMT, the Dutch research institute TNO and the CSIR's DPSS division was conducted in False Bay (at IMT) on the detection of small surface targets and atmospheric effects. The trial was conducted over a two-week period involving meteorological and electro-optic sensor systems (covering the visible to thermal infrared bands) from IMT, TNO and DPSS. The atmospheric effects trial quantified the magnitude of refraction, scintillation, transmission and optical blur. A wide spectrum of environmental conditions was encountered, ranging from hot, calm to typical winter storm conditions (low

pressure systems with associated strong winds and heavy rain). The trial was hugely successful in terms of the quantity and quality of data that was captured. A first and second paper on the trial were written and presented at international conferences. It is foreseen that five to six additional papers could be written on the data captured during this trial.

PROTECHNIK LABORATORIES

Protechnik Laboratories is an applied chemistry laboratory which performs chemical and biological research and development work for the Department of Defence (DOD). The field of work covers the domains of detection, decontamination, protection, synthesis, verification and biomedical.

The focus of the project work was on developing systems and techniques which could be used for both classical chemical and biological warfare agents as well as hazardous industrial chemicals. The reliable detection and identification of hazardous chemicals in the field remains a challenge as there is no one universal chemical detector. Project work focussed on the determination of a suite of detectors which could be used by detection team personnel to detect the identified threat chemicals. The results of the work showed that a minimum of five different detectors were needed to detect all chemical and radiological threats using different techniques. The work was performed with members of the bomb squad of the South African Police Service (SAPS) as well as with emergency services personnel of the major metropolitan areas. This work will lead to the establishment of trained detection teams equipped with a dedicated detection vehicle, and such teams would be deployed at large events such as the 2010 Soccer World Cup.

The prototype mass casualty and personnel decontamination systems were further improved and re-evaluated and the requirements for the production version of these systems can now be finalised.

The chemical agent test facility at Alkantpan was upgraded and experiments performed to determine the persistency of chemical warfare (CW) agents at very high temperatures and low humidity. Wind speed was found to be an important factor in the evaporation of the CW agent.

Improved versions of the fully encapsulated decontamination suit and the level 2 decontamination suit were made and

Review of Operations (continued)

evaluated. The improved versions were favourably received by the emergency services personnel, the SAPS forensic analysts and the chemical industry. A decision has been made for emergency services personnel to utilise these decontamination suits for chemical incidents during the 2010 Soccer World Cup.

A polymerase chain reaction (PCR) laboratory has been established and is capable of analysing suspected samples for a range of biological warfare agents and a number of samples have been analysed for the SAPS for the presence of anthrax.

The analytical chemistry capability has been improved by the acquisition of a new multinuclear NMR Fourier Transform spectrometer as well as a new infra-red spectrometer. Both these purchases were made possible by funding received from the Department of Trade and Industry (DTI).

Project work on the South African Navy (SAN) patrol frigates continued. The GID 2A CW agent detector and through bulkhead sampling system has been permanently installed on the SAS Mendi and has been found to work satisfactorily. A maintenance plan for the detector needs to be compiled. The cleansing station procedure of the SAS Mendi has been finalised and a number of changes to the cleansing station have been proposed.

The Service Level Agreement with the Department of Trade and Industry (DTI) and the Non-Proliferation Council (NPC) is functioning well. Once again Protechnik assisted with the organising of the Organisation for the Prohibition of Chemical Weapons (OPCW) Regional Assistance and Protection Course. This was attended by 25 participants from Africa. Protechnik has been asked by the OPCW to organise an analytical skills training course for African chemists and detailed discussions have been held.

Good relationships have been established with the SAPS Bomb Squad and Forensic Science Laboratory as well as emergency services personnel from Tshwane, Johannesburg and Ekurhuleni. Combined exercises will be held with these institutions so that a capability can be established to deal with large chemical incidents. In addition, a relationship has been established with the chemical group of the National Intelligence Agency (NIA) and this has developed to a stage where the NIA has hired a laboratory at Protechnik for its chemists.



HAZMAT Protective clothing

HAZMAT PROTECTIVE SYSTEMS

Hazmat Protective Systems manufactures and markets a comprehensive range of filter cartridges, canisters and half-mask respirators to protect the individual and soldier against the majority of respiratory health hazards. Hazmat also manufactures impregnated activated carbon, which is used in a range of cartridges, canisters and large industrial filter applications. Hazmat is one of only a few companies in the world capable of impregnating activated carbon. This technology was developed by the military in order to supply chemical and biological filters to the SANDF.

Hazmat's manufacturing process has been certified to ISO 9001:2000 by TÜV Rheinland since 1994, and all respiratory products are approved (homologated) by the SABS, or comply with the applicable military standard. Hazmat is currently the only local manufacturer of canisters and various chemical and biological filters. Filters were manufactured for the SANDF in the past financial year to replace expiring filter stocks, not only for military use but also if needed during the 2010 Soccer World Cup.

Aircraft manufacturing organisation approval from the South African Civil Aviation Authority was maintained

Review of Operations (continued)

to manufacture shower water filters for the SAAF VIP Intercontinental Aircraft. Hazmat is currently the sole manufacturer of these water shower filters.

Critical capital equipment was purchased during the review period to upgrade, improve and maintain the strategic canister filter manufacturing capability.

DEFENCE INSTITUTE

Defence Institute focuses on supporting the Department of Defence in achieving defence excellence and maintains a number of centres of excellence required to analyse problem areas and to act as advisors on short, medium and long-term decisions. This service is rendered over the full life cycle of defence capabilities, and is organised as a matrix organization with the emphasis on client support and to maintain the strategic partnership with all relevant stakeholders.

Capability Development

The aim of the project is to find an auditable method for determining the long-term capability requirements of the SANDF.

This project has adopted and adapted the international benchmark for determining long-term capabilities. Amongst other things it gave rise to Scenario Based Capability Analysis as a basis for determining future capability requirements. A generic set of force employment scenarios has been developed, covering most variables of the African continent. Supporting processes and a toolset have been developed to first identify and then deduce the relationships between influences in battle space and possible effects to be achieved on them by executing a set range of joint tasks. Methodologies have been developed and tested for specifying capability requirements, creating virtual solutions and thereafter linking them to current and emerging force realities. The process has intentionally been designed for broad participation by the services and divisions to prevent surprises and a lack of ownership.

The project is now entering the implementation phase of the capability development approach for the shared joint vision of long-term future capability requirements, which will promote integration between the services/divisions. It will enhance their ability to align and prioritise spending in the operating, capital and technology budgets.

Command and Control Staff Support

The Command and Control Staff Support Project team provides staff support to the JOPS division for the development and maintenance of Command and Control Concepts, doctrines, Command and Control Portfolio Master Plans, and Command and Control Systems Architectures (Current and Future).

The tasks and activities on this project are coordinated with the activities executed in the Integrated Development Environment.

Joint Command and Control Technology

Project Joint Command and Control Technology is a technology project that is defining, testing and evaluating Joint Command and Control systems concepts and related systems architectures. This project is the continuation of Project SIMUNYE, focussing not only on Joint Air Defence but on Joint Command and Control as a whole.

The project participated in Exercise Green Point and identified technologies were successfully demonstrated during the course of the exercise.

The tasks and activities on this project included the investigation of issues pertaining to Global Track Management, Generic Data Models and Automated Decision Support. These technology issues are coordinated with the activities executed in the Integrated Development Environment.

Integrated Development Environment (IDE)

The concept of the IDE follows on from the SIMUNYE approach where – via a build a little, test a little approach – the IDE will be used to assist in identifying, developing and verifying, in a logical and rational manner, the operational concepts and doctrine required to conduct joint operations. In addition, the IDE will assist in the identification, demonstration and specification of optimised networks and ICS requirements. This moderate approach, as opposed to a big bang approach, will ensure that all Command and Control system users and providers are aligned in the requirements for a joint Command and Control system, and the risks are reduced in that systems are specified by operational users which are in line with technological solutions within the African Battle space and budget expectations of the DOD.

Review of Operations *(continued)*

The execution of activities and work done on this project focused on the integration of systems required during interdepartmental (SANDF and Police) operations, and it was successfully demonstrated during Exercise Green Point. The tasks and activities on this project are coordinated with the activities executed in the Command and Control Staff Support and Joint Command and Control Technology projects.

Weapon System Decision Support

The purpose of the Weapon System Decision Support (WSDS) project is primarily to maintain and expand a decision support capability that is able to meet the requirements of the DOD, at the Defence Institute. This has included studies of developments in and the tools and methodologies of decision science and studies of topics of a military functional nature, which provided background knowledge for the application of decision support

Integrated Logistic Support

The SA Army environment, and specifically the Director Army Product System, is engaged in the enhancement and creation of enablers and governance supported by related processes, which are required to manage products systems in the SA Army and needs the assistance of Defence Institute to achieve this.

The purpose of the project is to provide staff support for System Management Enhancement (SME), which encompasses Integrated Logistic Support (ILS), Capability Management and related processes as well as the provision of governance to Products System Management in the SA Army.

Product System Management Staff Support

The projects that fall in this category of work are, currently, addressing SA Army Products Systems. The essence of the work is to deliver scientific decision support, data analysis and objective independent reporting to the specific Products Systems Managers. The areas that are addressed by this support include baseline management, material readiness analysis, failure trend analysis and investigations, operational data analysis and systems and logistics engineering support.

FLAMENGRO

The Fluid and Mechanical Engineering Group maintains

a minimum sustainable capability in Computer Aided Engineering (CAE) software and hardware, with specific emphasis on ballistics simulation, modelling and analysis and verification experiments.

Scientific and engineering support is provided to the industry on the design and development of artillery systems, as well as to the SANDF on the operational use of such systems.

Achievements of recent developments include the testing of a pyroxene type primer to replace the existing M82 primer. The main emphasis is aimed at ensuring a more constant functioning of the primer by increasing the blow down time and regulating the rupture pressure of the burst disk. The aim to optimise the primer is twofold, namely to ensure that a constant signal is sent to the charge igniters, and to ensure that a tight fit is maintained between the primer and the spindle to prevent expulsion leading to the sticking primer problem. At present the burn time has been increased by a factor of 5.

ERGONOMICS TECHNOLOGIES (ERGOTECH)

Ergotech provides a comprehensive service in ergonomics (human factors) to the DOD in order to satisfy its requirement for a Structured Ergonomics Programme ensuring the effective and efficient integration of ergonomics in all defence systems. The services for the last year included military ergonomics research in the areas of soldier perception, anthropometry (human body size), soldier functional and physiological performance; specification and design of human-machine systems; the evaluation of environmental stressors (such as vibration, humidity, temperature and noise), human-machine systems and specialised health and safety investigations that are unique to our soldiers and the environments in which they have to operate.

Ergotech is responsible for the generation and maintenance of the soldier characteristics databases for the SANDF. The data are critical for the successful integration of ergonomics into soldier equipment and systems within the context of the operating environment.

The division's main objective for the past year was to provide an efficient high-quality ergonomics service to the DOD. This was achieved with the timeous delivery of all contracted outcomes. Quality received concerted

Review of Operations (continued)

attention and Ergotech was recertified for ISO 9001:2000 accreditation. During the last year the following project objectives have been achieved:

Recent research on the characterisation of the soldier's foot involved the utilisation of three dimensional laser-scanned foot images to extract critical form, dimensional and relational data to enable improved footwear design for the soldier. The anthropometric database of the SANDF was kept current with the addition of an age targeted sample to increase the age representivity of the database population. This will improve the accuracy of future ergonomics specifications and the design applicability to the SANDF population.

Effective protection of the soldier against the harmful effects of the military induced environment is vitally important. The effect of SANDF noise protection devices on speech intelligibility was investigated as part of the optimisation of soldier performance and its contribution to overall operational system effectiveness. Also investigated was the protection against noise. Together, these studies enable Ergotech to advise the DOD on the risks of military tasks and their effects on soldier performance.

Work continued on the modelling capabilities to support acquisition decision-making pertaining to ergonomics. The biomechanics modelling capability was utilised to verify soldier force exertion capabilities and the risk of in-field patient manual handling. The soldier performance modelling capability focussed on mental workload prediction methods within a combat management system.

Ergotech was also involved in the evaluation of the effectiveness of the introduction of new technology devices to improve navigation, the development of a fire retardant coverall ensemble for the operational crews of the SA Navy, and the evaluation of operational emergency care practitioner backpacks for the South African Military Health Service.

ARMOUR DEVELOPMENT

This specialised division conducts continued research and development to maintain and advance armour protection technologies and to establish industrial capability to timeously satisfy armour protection requirements over the entire threat spectrum in a cost effective manner.

This service includes analysis of the customer protection needs, development of armour, testing and qualification,

vehicle hull structural and ballistic design as well as specification of bonding or welding. This division has extensive experience in retro-fitting armour packages on main battle tanks and light armoured vehicles.

During the period under review ongoing research work was conducted for passive and reactive armour technology. New reactive armour was developed in order to limit the damage caused to own vehicles and enhance the safety of unprotected personnel around them. Concept confirmation trials were done with electric armour principles; standard 45 mm and 90 mm shaped charges were developed, specifically to be used as research tools in this field of development.

The development of the combat armour suite for the New Generation Mechanized Infantry Combat Vehicle has largely been completed. The effort to improve the mass- and cost-effectiveness of armours against fragments from artillery and improvised explosives devices remains a high priority for personnel protection.

The challenge facing Armour Development is the short-supply, high prices and long lead times for qualified armour steels both for research and production.

DEFENCE MATÉRIEL DISPOSAL

Defence Matériel Disposal (DMD), a division of Armscor Business, is mandated to sell excess and obsolete defence materiel on behalf of the Department of Defence, to the best advantage of the State. Such defence materiel includes for instance ammunition, aircraft, spares, vessels, land and/or air-based equipment.

The sale of the defence matériel is carried out in accordance with the requirements of the Department of Defence and government approved regulatory authorities such as the National Conventional Arms Control Committee and the National Proliferation Committee.

DMD's sales target for the 2007/08 financial year was not achieved due to changes imposed upon DMD regarding the sales approval process as well as other factors such as the restrictions imposed by the DCAC on the sales of Samil vehicles, SANDF vehicles disposed of not being registered by the arms of service on NATIS prior to disposal and the donation of disposed stock by the DOD, which had to be withdrawn from DMD sales plans.

Review of Operations *(continued)*

DMD was approached by the office of the Secretary for Defence to render assistance with donations of both disposed and non-disposed SANDF equipment to countries in Africa. The donations and other peacekeeping initiatives had a negative effect on DMD's sales turnover, but DMD was still instrumental in executing its disposal role to the best advantage of the State.

DMD continued to successfully manage defence materiel warehouses at the following locations: DMD Naval Depot in Wingfield, DMD Air Force Depot in Thaba Tshwane, DMD Main Ordnance Depot in Tshwane, DMD MOD Centre Bloemfontein, and the DMD Army Depot at Wallmansthal.

DMD was also approached by its DOD Stakeholders to expand the DMD services rendered to the DOD to include the NaTIS registration of B and D vehicles disposed of and assistance during milestone 2 to 4 of the DOD's disposal process.

DMD is proud of the ever-increasing demand for its services, but with the decline in the disposal of major systems and the increase in the scope and cost of services rendered, funding for these services may become a restricting factor going forward.

ARMSCOR DEFENCE ASSET MANAGEMENT CENTRE (ADAC)

Armcor Defence Asset Management Centre (ADAC) provides asset management support to assist the defence environment in reaching its full potential. ADAC's mandate is derived from Armcor's core business. It distinguishes itself by its ability to align its support capabilities with client requirements, and by being able to understand and accommodate the varied and diverse organisational needs of its clients. ADAC renders the following services corporately to Armcor and on behalf of Armcor:

Intellectual Property Management Support Service (IPMS)

ADAC acts as the custodian of DOD intellectual property documentation in Armcor's possession. Data and information integrity are ensured by applying configuration management principles in the administration thereof within a configuration database. The database comprises 236 852 document and 44210 item records.

Document Digitising Service

The function of this service is to digitise the large volumes of paper-based DOD programme-related documents and data items in Armcor's possession. The service plays an important role in distributing information in electronic format to all applicable stakeholders. A total of 225 937 pages were digitised in the 2007/08 period.

Project Asset and Accounting Management Service

All DOD assets managed by Armcor in the Armcor acquisition-related programmes are accounted for in a central asset register. Assets are, furthermore, verified on an annual basis. During the reporting period, which involved contractors at 333 locations countrywide, a 99,2% confirmation has been obtained.

DOD Stores and Equipment Management Service

The service allows for the management of all DOD stores and equipment in Armcor's possession. A DOD Logistic Information Management System is utilised for accounting, enabling the integration of work processes and information flow between the DOD and Armcor. Accounting is also done for surplus and redundant DOD stores and equipment transferred to Armcor for alienation.

Ammunition Marking Service

ADAC works in close cooperation with the DOD and the Defence Industry in the creation and management of ammunition marking drawings. A total of 13 000 drawings are involved. ADAC also renders a codification and packaging advice service.

Assets, Stores and Equipment Disposal Service

The disposal service conducts, in association with the DOD, the disposal of all identified, redundant, obsolete and unserviceable DOD assets, stores and equipment in possession of or controlled by Armcor. The process involves disposal investigations, submissions and finalisations.

Challenges facing ADAC are the recruitment and maintaining of a skilled workforce and to negotiate and obtain capital funding to replace and substitute outdated technologies and equipment.

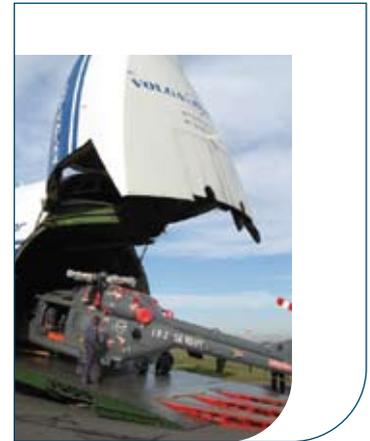
Review of Operations (continued)



Ammunition with distinctive markings



AB Logistics



AB Logistics

AB LOGISTICS

AB Logistics Freight renders logistic services in support of Armscor's strategic acquisition function, for the SANDF and the South African defence-related industry. AB Logistics Freight is a registered and accredited customs clearing agent with the South African Revenue Service (SARS), and is a member of the International Air Traffic Association (IATA), the Internal Federation of Freight Forwarders Associations (FIATA) and the South African Association of Freight Forwarders (SAAFF).

AB Logistics Freight is responsible for various logistic services, such as packaging, freight forwarding, chartering, road haul transportation, customs and shipping formalities, and information and data capturing to comply with the Armaments Compliance requirements during the importation and exportation processes. All these services are vital to the Armscor acquisition process, the SANDF and the defence-related industry, and – in view of the nature of the commodities handled – vital in terms of the Armaments Compliance requirements.

AB Logistics Freight has, through its capabilities, also extended its specialised services to various Government departments and to foreign defence forces.

South Africa's international acceptance has resulted in joint exercises held between the SANDF and foreign defence forces, with AB Logistics rendering the logistical support required by the visitors for the freight forwarding of their

military equipment. During the year under review AB Logistics rendered logistical support for four such joint military exercises. The foreign defence forces had indicated their preference to task a logistical service provider that is part of the Department of Defence and, based on the high standard of service rendered by AB Logistics in the past, has resulted in these logistical support services being contracted for the next two years by the foreign defence forces.

In terms of the Explosives Act, AB Logistics Freight is also a registered explosives transporter, offering this specialised service to the SANDF, Armscor, foreign Defence Forces and the defence-related industry through its trained personnel and with its own fleet of trucks.

In terms of the Firearms Control Act, 2000, AB Logistics is authorised to transport firearms and ammunition. In this role it has emerged as a leader in handling mainly sensitive, controlled and hazardous cargo. Its fleet of trucks is under constant satellite surveillance to ensure traceability of the movement of the cargo. Assistance is rendered to foreign clients and shipping lines with the transit of shipments of such controlled items through South Africa.

Based on the diversified activities and the experience vested within AB Logistics, integrated logistics services are offered, such as packing, stuffing, lashing, customs clearing of air and sea freight shipments, and chartering of ships and aircraft. AB Logistics Freight provides transit warehousing facilities, marine insurance, customs tariff consultancy, and computerized clearances linked with the SARS electronic data interchange system, costing facilities, and a "Removal

Review of Operations (continued)

in Bond" cartage service.

AB Logistics has contributed substantially to Armscor's BEE Strategy in terms of expenditure and the transformation process.

AB Logistics is currently playing an important role in the shipping and customs clearance process of the Strategic Defence Packages (SDP) equipment. The special customs and excise manufacturing warehouse facility is in full operation and handles all the required extensive administration processes to ensure that all the customs rules and formalities are complied with. A total of 23 LUH A109 helicopters and 20 Hawk aircraft were customs cleared out of this warehouse facility, while a number of components are still imported into this facility for the local manufacture of the remainder of the LUH A109 helicopters and Hawk aircraft. The manufacturing of certain parts for the Gripen fighter and the Airbus A400M military cargo aircraft is also supported by this warehouse facility. The last of three submarines was customs cleared during February 2008. The second Gripen fighter aircraft was shipped and customs cleared into this special customs and excise manufacturing warehouse pending final acceptance and clearance.

Through this special customs and excise manufacturing warehouse facility it has been possible to effect a substantial saving on import-related costs. AB Logistics has developed a computerised system for capturing the data of the items that are imported and exported through this warehouse facility, offering reconciliation reports per the different projects in order to comply with Customs requirements. With some of the deliveries scheduled to be finalised during 2008, the reconciliation reports will have to be finalised for

closing the projects with SARS: Customs.

AB Logistics Travel is a registered member of the International Air Transport Association and the Association of South African Travel Agents. Its main business is to provide a 24-hour travel service to assist Armscor and Armscor contractors with all their defence and project-related travel arrangements. In the year under review the Defence Force has contracted AB Logistics Travel to render travel assistance to them. This will be done through the offices at Thaba Tswane, Simon's Town and Armscor head office. AB Logistics Travel offers a diversified range of travel arrangement support, including air travel, land travel, car rental, accommodation, and other related services.

The shipment of military commodities and explosives has become more complex due to limited shipping opportunities. AB Logistics is confronted by exciting challenges in exploring new shipping routes at cost-effective rates and recruiting and maintaining its skilled workforce.

HUMAN RESOURCES

The human capital of Armscor remains the key contributor to its success. It has become increasingly important to retain and rejuvenate the scarce skills within the challenges of transformation requirements and the high demand for the specialist technical skills in the market in general.

STAFF COMPOSITION

The staff profile of Armscor, excluding the Armscor Dockyard, was as follows on 31 March 2008, per broad band, race and gender:

Review of Operations (continued)

Broad band	AFRICAN		COLOURED		INDIAN		WHITE		TOTAL		GRAND TOTAL
	M	F	M	F	M	F	M	F	M	F	
EX	3	2	0	0	0	0	0	0	3	2	5
SU	5	3	2	0	1	0	43	3	51	6	57
MP	34	10	9	1	12	4	284	35	339	50	389
STS	38	38	12	7	5	8	35	87	90	140	230
AS	44	61	11	21	0	4	9	44	64	130	194
OS	42	29	4	2	0	0	0	0	46	31	77
TOTAL	166	143	38	31	18	16	371	169	593	359	952
%	17.44%	15.02%	3.99%	3.26%	1.89%	1.68%	38.97%	17.75%	62.29%	37.71%	100.0%
	32.46%		7.25%		3.57%		56.72%		100.0%		
	43.28%						56.72%		100.0%		
										Male	62.29%
										Female	37.71%
										100.00%	

The table indicates that Armscor has a workforce of 952 employees (excluding the Armscor Dockyard). More than 43.2% were Black, 32.46% are African and 37.7% are female.

TRANSFORMATION

Transformation remains one of the key challenges and focus areas within the organisation.

As a consequence of continuous efforts and focused actions the racial profile has changed substantially and the gender profile slightly over the last 10 years as evident in the following:

- The % black employees has grown from 23,29% in March 1998 to 43,28% in March 2008.
- The % female employees has grown from 34,57% in March 1998 to 37,71% in March 2008.

Performance in this regard is driven by specific targets, action plans and continuous measurement and monitoring. The specific targets and achievements during the year were as follows:

- Target: At least 80% of all new appointees in Armscor to be black.

Performance: At the end of the year 90,9% of all new appointments were from the black group.

- Target: At least 20% of external appointees in the technical functional group to be women.

Performance: 20% of external appointees in the technical functional group were women.

- Target: At least 65% of external appointees in the non-technical functional group to be women.

Performance: 63,8% of external appointees in the non-technical functional group were women.

- Target: At least 29% of employees in the broad bands STS and above to be women.

Performance: 29,1% of employees in the broad bands STS and above are women.

The transformation targets are supported by focused recruitment actions as well as the bursar scheme and a Talent Development Programme to grow the internal sources for appointment. This is further supported by

succession and rejuvenation plans.

RETENTION AND REJUVENATION

The age distribution of the workforce is a major risk area for the organisation in terms of service delivery in future. More than 35,8% of the workforce are older than 50 years and more than 5,5% are older than 60 years. More than 40% of the technical employees are older than 50 years and 6,52% are older than 60.

The retention of key technical capabilities remains problematic in the volatile business environment within South Africa and internationally. The labour turnover has increased from 4,82% in 2005/06 to 7,6% in 2006/07 to 8,9% in 2007/08. The turnover of 11,25% among blacks employees is especially high. This is mainly driven by the shortage and demand of technical skills in this key group in the market and Armscor's inability to compete with market-related remuneration. More than 30% of the terminations were employees in the scarce skills category.

A number of strategies were adopted to address the two issues above. Among them are a detailed succession planning and development strategy, a transformation and renewal strategy including planned skills transfer actions, and a drive to motivate additional transfer payment to enable the organisation to implement a catch-up strategy on remuneration. During the reporting period a special scarce skills increase of 1,13% was given to technical employees who met the critical criteria in the core technical departments. The organization average remuneration is still more than 13% below the 50th percentile in the market. The strategies are all focused on the medium to longer term. On the shorter term the organisation endeavours to bring new employees in on higher salaries. This is having a positive effect on the new employees but it does create a future risk for the morale of longer service employees.

SKILLS DEVELOPMENT

The skills levels of Armscor employees are one of the most important drivers of successful service delivery. For this reason skills development remains an important focus area. A number of initiatives have been ongoing in this area.

E-learning

Armscor has progressed well on the implementation of e-learning as one of the platforms for the development of skills. The nature of the work environment in Armscor (e.g. time constraints, access to work stations and the Internet, the self-discipline nature of the typical Armscor employee) is very suited for this kind of learning delivery.

Courses are delivered to personnel via an intranet-based Learner Management System (LMS) that is fully operational. The LMS tracks the learner's progress and facilitates the learning process. Courses have been developed to meet Armscor's special needs, e.g military culture and armaments acquisition. It also utilizes off-the-shelf courseware for generic skills like business and computer skills.

E-learning has gained good acceptance as a viable means of skills development, as evidenced by the growing number of learners enrolling for the various courses.

Some courses are still presented using the traditional classroom delivery methods.

Learnerships

The Services SETA sponsored twenty Armscor personnel on their Supervisor Learnership, leading to the qualification National Certificate, Generic Management, NQF level 4.

This learnership was completed at the end of August 2007 and was uniquely and satisfactorily conducted using a blend of self-paced e-learning, coaching and workshops. Of the 20 that started, 16 completed the learnership successfully within the planned timescales.

Talent Development Programme

The Talent Development Programme (TDP) provides opportunities for newly qualified talent, typically from designated groups, to gain meaningful experience in the Armscor work environment. The incumbents are contracted for periods ranging from one to two years during which time they gain work experience whilst on a formal coaching programme. In the past year 15 incumbents participated on the programme – 14 were from the black group (9 African, 1 Coloured and 4 Indian) and three were female. Of these seven were appointed in full-time positions and one resigned.

Review of Operations (continued)

In addition to the Talent Development Programme, Armscor also has a bursary scheme serving as a feeder for the recruitment of new talent. Bursaries for engineering were granted for four students, all from the black group. The scheme has been extended to nine students for 2008/09. To make the scheme more attractive and competitive the bursaries have been reviewed to cover the full cost of studying.

Adult Basic Education and Training (ABET)

Armscor provides Adult Basic Education and Training to twenty-two Armscor and fourteen other (i.e SANDF) personnel.

The courses offered are limited to numeracy and literacy at ABET levels 1 to 4.

However numeracy and literacy do not ensure that ABET learners will be able to rise above menial chores, and even NQF level 1 qualification would not be sufficient because of its academic orientation. So instead of offering the NQF Level 1 qualification as an extension to the education an extended ABET Programme was devised which provides training in useful business-related skills, such as basic computer skills and customer satisfaction. This has been well received by learners and managers alike, and promises to provide the opportunity for these disadvantaged adults to integrate into the main stream business activities.

LABOUR RELATIONS

Armscor signed a recognition agreement with the Solidarity Union in January 2008. In terms of the agreement Armscor will in future have to negotiate with the union on all changes affecting the employment of employees including the annual general remuneration increase.

The organisation still maintains the Armscor Consultative Group (ACG) as the forum for consultation with all employees on a broad base of issues.

SAFETY, HEALTH AND ENVIRONMENT (SHE)

During the year under review, Armscor continued to deploy the corporate SHE strategy.

SHE audits were conducted at Armscor Head Office as

well as at the combined Protechnik, Hazmat and Ergotech facilities. Significant improvements have been noted at Head Office. Specific areas of concern have been identified at the Protechnik, Hazmat and Ergotech facilities, which will be addressed in the next financial year.

Health and wellness

The Armscor Health and Wellness Programme is in line with the National Health Observance Calendar, which is recognized by the National Department of Health as well as the World Health Organization (WHO). Armscor therefore supports the quest to improve the quality of our people's physical health and natural healing ability. Health and wellness services are available on a daily basis throughout the year. Every month different health and wellness themes are focussed on, e.g. January is safety awareness month and February is safe sex awareness month. Flu vaccination is also available free of charge to Armscor employees.

HIV/AIDS

Peer educators are trained in Armscor to act as counsellors for people who are infected with HIV/AIDS. Treatment is available and a concerted effort is made to ensure that people with HIV/AIDS are not discriminated against. The following can be reported for the year:

- 6 employees received AIDS counselling;
- 15 employees attended voluntary HIV/AIDS counselling and aids testing sessions;
- 22 employees received training on HIV/AIDS;
- 180 employees were tested during the Wellness Week, where 2 employees tested positive.

Employee assistance programme

This programme is designed to assist in the identification and resolution of productivity problems associated with employees impaired by personal concerns – such as health, marital, family, financial, alcohol, drug, legal, emotional, stress, etc. – which may adversely affect employee job performance. The number of employees counselled was 117, as follows:

Review of Operations *(continued)*

- 2 for work-related problems;
- 55 for financial problems, mainly because the performance bonus was not paid;
- 45 for health problems; and
- 15 for marital problems.

EXHIBITIONS AND EVENTS

Armcor, with the support of the Department of Trade and Industry (DTI), facilitated the participation of the defence-related industry in the following exhibitions: DSEI 2007 in the United Kingdom, Milipol 2007 in France, DEFEXPO 2008 in India, SOFEX 2008 in Jordan and FIDAE 2008 in Chile.

These exhibitions provided a platform for the South African defence-related industry to showcase its capabilities and to encourage exports.

Group Annual Financial Statements



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Report of the Audit and Risk Committee

The Audit and Risk Committee reports that it has adopted appropriate formal terms of reference as its Audit and Risk Committee charter, and that it has discharged all of its responsibilities as contained therein.

The Audit and Risk Committee is satisfied, based on the information and explanations given by management and the corporate audit division, as well as through discussions with the Auditor-General on the result of their audits, that an adequate system of internal control is being maintained to:

- reduce the entity's risk to an acceptable level;
- meet the business objectives of the group;
- ensure that the group's assets are safeguarded; and
- ensure that the transactions undertaken are recorded in the entity's records.

The Audit and Risk Committee evaluated the deviation reported by the Auditor-General with regard to amendments to the financial statements resulting from their audit. Matters affecting the financial statements were as stated hereafter. No further action is required as the necessary changes were effected.

- The disclosure of an amount receivable to the value of R35,2 million with a repayment term of more than 12 months was reclassified from short term to long term
- The related parties note was expanded to include the balances owed to/by the subsidiaries as only the transactions that occurred between the parties during the period were disclosed together with a note referring the reader to the relevant notes on investment and loans of the subsidiaries in the relevant sections of the financial statements.

The Audit and Risk Committee has evaluated the annual financial statements of the Armscor group for the year ended 31 March 2008 and considers that it complies, in all material respects, with the requirements of the Public Finance Management Act (Act No 1 of 1999), as amended, as well as South African Statements of Generally Accepted Accounting Practice.

The Audit and Risk Committee agrees that the adoption of the going concern premise is appropriate in preparing the annual financial statements. It has therefore recommended the adoption of this annual report to the Board of Directors at their meeting on 15 August 2008.



Mr E L Borole
CHAIRPERSON

13 AUGUST 2008

REPORT OF THE AUDITOR-GENERAL TO PARLIAMENT ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE ARMAMENTS CORPORATION OF SOUTH AFRICA LIMITED FOR THE YEAR ENDED 31 MARCH 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements and financial statements of the Armaments Corporation of South Africa Limited which comprise the consolidated and separate balanced sheets as at 31 March 2008, and the consolidated and separate income statements, consolidated and separate statements of changes in net equity and consolidated and separate cash flow statements for the year then ended, and a summary of significant accounting policies and other explanatory notes and the director's report, as set out on pages 52 to 103.

Responsibility of the accounting authority for the financial statements

2. The accounting authority is responsible for the preparation and fair presentation of these financial statements in accordance with South African Statements of General Accepted Accounting Practice (SA Statements of GAAP) and in the manner required by the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA), the Companies Act, 1973 (Act No. 61 of 1973) and the Armaments Corporation of South Africa, Limited Act, 2003 (Act No. 51 of 2003). This responsibility includes:

- designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- selecting and applying appropriate accounting policies
- making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

8. In my opinion the financial statements present fairly, in all material respects, the consolidated and separate financial position of the Armaments Corporation of South Africa Limited as at 31 March 2008 and its consolidated and separate financial performance and cash flows for the year then ended, in accordance with South African Statements of Generally Accepted Accounting Practice (SA Statements of GAAP) and in the manner required by the PFMA and the Companies Act, 1973.

Emphasis of matter

Without qualifying my audit opinion, I draw attention to the following matter:

Going concern

9. Attention is drawn to the director’s report page 55 in which the process of transforming Armscor at a strategic level is discussed, together with the impact that this will have on the group in future periods.

OTHER MATTER

Without qualifying my audit opinion, I draw attention to the following matter that relates to my responsibilities in the audit of the financial statements:

Matters of governance

10. The PFMA tasks the accounting authority with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	YES	NO
Audit committee		
• The Armscor Group had an audit committee in operation throughout the financial year.	X	
• The audit committee operates in accordance with approved, written terms of reference.	X	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 77 of the PFMA and Treasury Regulation 27.1.8.	X	
Internal audit		
• The Armscor Group had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.	X	
The internal audit function substantially fulfilled its responsibilities for the year, as set out in Treasury Regulation 27.2.	X	
Other matters of governance		
The annual financial statements were submitted for audit as per the legislated deadlines section 55 of the PFMA for public entities	X	
The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.	X	
The prior year’s external audit recommendations have been substantially implemented.	X	

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

11. I have reviewed the performance information as set out on pages 56 to 61.

Responsibility of the accounting authority for the performance information

12. The accounting authority has additional responsibilities as required by section 55(2) (a) of the PFMA to ensure that the annual report and audited financial statements fairly present the performance against predetermined objectives of the public entity.

Responsibility of the Auditor-General

13. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*.
14. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

Audit finding (performance information)

15. I believe that the evidence I have obtained is sufficient and appropriate to report that no significant findings have been identified as a result of my review.

APPRECIATION

16. The assistance rendered by the staff of the Armscor during the audit is sincerely appreciated.

Auditor-General

Pretoria

31 July 2008



AUDITOR-GENERAL

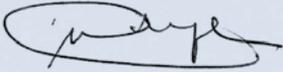
Directors' approval of the annual financial statements

The Board recognises and acknowledges its responsibility for the group's internal control systems. Management is responsible for preparing the annual financial statements and the group annual financial statements in accordance with generally accepted accounting practices.

The directors, supported by the Audit and Risk Management Committee, are satisfied that management has introduced and maintained adequate internal controls to ensure that dependable records exist for the preparation of the financial statements, to safeguard the assets of the group and to ensure that all transactions are duly authorised.

Against this background the directors of the Corporation accept responsibility for the financial statements. The information on pages 51 to 103 was approved by the Board of Directors on 15 August 2008.

Signed on behalf of the Board by:



Dr PS Molefe

CHAIRMAN

The composition of the Board

The composition of the Board of Directors during the year under review was as follows:

Term of office of Directors

Board Member	Date of Appointment	Date of Expiry	Date of Re-Appointment	Date of Expiry	Date of Extension	Date of Expiry of Extension	Term Served
PS Molefe	1 Oct 2004	30 Sep 2007	1 Oct 2007 (Extension)	31 March 2008 (Expiry of extension)	1 April 2008 (Re-appointment)	31 March 2011 (Date of Expiry)	1
RP Meyer	1 Oct 2004	30 Sep 2007	1 Oct 2007 (Extension)	31 March 2008 (Expiry of extension)	1 April 2008 (Re-appointment)	31 March 2011 (Date of Expiry)	1
HS Thomo	10 July 2002 (His appointment is linked to his position as the Chief Executive Officer)						
CV GAMEDE	1 Sep 2001	31 Aug 2004	1 Sep 2004	31 Aug 2007	1 Sep 2007	31 March 2008	2
P RIBA	1 May 2004	30 April 2007	1 May 2007 (Extension)	31 March 2008	31 March 2008	31 March 2008	1
AS HUMAN	1 March 2002	28 Feb 2005	1 March 2005	29 Feb 2008	1 March 2008	31 March 2008	2
COL GN RAMAREMISA	1 Sep 2001	31 Aug 2004	1 Sep 2004	31 Aug 2007	1 Sep 2007	31 March 2008	2
CJ HOFFMANN	1 Aug 2004	30 Nov 2007	Retired		-	-	1

Company Secretary

Name	Date of Appointment	Date of Expiry	Term Served
Ms TN Msomi	1 January 2007	The Company Secretary is full-time employee of the organisation	1

AUDITORS

Auditor-General

BANKERS

ABSA Bank

REGISTRATION NUMBER

1968/008611/06

REGISTERED OFFICE

370 Nossob Street
Erasmuskloof Extension 4
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COMPANY SECRETARY

Mrs TN Msomi
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Private Bag X337
Pretoria 0001

DIRECTORS' REPORT

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DIRECTORS' REPORT (continued)

Introduction

The Armaments Corporation of South Africa Limited ("Armcor") is a statutory body, established in terms of the Armaments Development and Production Act (Act No 57 of 1968), and continues its existence through the Armaments Corporation of South Africa, Limited Act (Act No 51 of 2003) and the Armaments Corporation of South Africa, Limited Amendment Act (Act No 16 of 2005), which came into effect on 8 May 2006. With the approval by the Shareholder of the Blueprint on Armcor Transformation, it is envisaged that the Armcor Act will be amended to reflect the responsibilities of the organisation in line with the said approval.

Armcor is also governed by the Public Finance Management Act (Act 1 of 1999), as amended (PFMA).

This report is therefore presented in terms of the provisions of the PFMA. It provides an overview on the performance of Armcor, measured against performance targets that the Corporation had set itself for the financial year.

Corporate governance

Board accountability

The Board of Directors adheres to the principles of good corporate governance as espoused in the PFMA, King II Report and Protocol on Corporate Governance in the Public Sector. This entails the provision of oversight over the management of the assets of the organisation diligently and in a fair and transparent manner. During the year under review great effort went into the streamlining of reporting to the shareholder in the form of a Shareholder Compact, Service Level Agreement and corporate plan to ensure that the targets, measures and outputs are clearly articulated to enhance the Board's accountability.

The Board placed much emphasis on the transformation of the organisation and that the transformation Blueprint was approved by the Minister. Priority was also given to the review of the acquisition processes to ensure that these are functioning properly and their integrity is ensured. This was an important initiative given that the core business of Armcor is acquisition of defence matériel and that it involves the utilisation of massive public resources.

Good corporate governance requires that the organisation in conducting its business takes into account the policy and legislative imperatives of government. With respect to the internal transformation, the organisation put in place practices that regulate employment equity as regards staff appointments and incorporation of black economic empowerment in acquisition and procurement contracts.

The Board, in discharging its obligations and to effectively fulfil its fiduciary role, is supported by the following subcommittees:

- Audit and Risk Committee;
- Human Resources Committee; and
- Executive Committee.

The Board as the Accounting Authority has delegated the Corporation's daily management to the Management Board under the leadership of the Chief Executive Officer.

Schedule of attendance of Board and Board Committee meetings appears on the next page hereto

The Board meets at least eleven times per year. The Company Secretary is responsible for ensuring both the effective functioning of the Board and the proper administration of the Board proceedings.

DIRECTORS' REPORT (continued)

Details of attendees of Board and committee meetings 2007/08

Names	Board of Directors Meetings	Audit and Risk Committee	Human Resources Committee	Executive Committee Meetings	Special Board of Directors Meetings	Special Board In-Committee Meetings
Dr PS Molefe	11 out of 12	Non-member	Non-member	-	2 out of 2	1 out of 1
Mr HS Thomo (CEO)	12 out of 12	3 out of 3	3 out of 3	-	2 out of 2	Non-member
Mr CV Gamede	10 out of 12	Non-member	3 out of 3	-	0 out of 2	1 out of 1
Ms AS Human	12 out of 12	Non-member	3 out of 3	-	2 out of 2	Non-member
Gen (Ret) GN Ramaremsa	12 out of 12	Non-member	3 out of 3	-	2 out of 2	Non-member
Mr RP Meyer	9 out of 12	1 out of 3	Non-member	-	0 out of 2	Non-member
Ms P Riba	11 out of 12	2 out of 3	3 out of 3	-	2 out of 2	1 out of 1
Mr CJ Hoffmann (CFO)*	9 out of 9	3 out of 3	Non-member	-	2 out of 2	Non-member
*Officially resigned as Board member with effect from 1 December 2007						
External members						
Ms CWN Molohe	Non-member	2 out of 3	Non-member	-	-	-
Mr MD Nkhabu	Non-member	2 out of 3	Non-member	Non-member	Non-member	Non-member
Company Secretary						
Ms TN Msomi	11 of 12	3 out of 3	3 out of 3	-	2 out of 2	1 out of 1

Special and Extra-ordinary meetings of the Board Committees and Sub-Committees 2007/08

Names	Special Human Resources Committee	Special Human Resources Sub-Committees		Special Committee on Internal Investigation – Vistula Special Board of Directors Meetings
		BSC	Grievance	
Mr HS Thomo (CEO)	4 out of 4	Non-member	1 out of 1	Non-member
Mr CV Gamede	4 out of 4	4 out of 4	11 out of 11	Non-member
Ms AS Human	4 out of 4	2 out of 2	1 out of 1	2 out of 2
Gen (Ret) GN Ramaremsa	4 out of 4	2 out of 2	1 out of 1	Non-member
Ms P Riba	4 out of 4	3 out of 3	10 out of 11	1 out of 2
Mr RP Meyer	Non-member	Non-member	Non-member	2 out of 2
Company Secretary				
Ms TN Msomi	3 out of 4	3 out of 3	9 out of 11	2 out of 2

DIRECTORS' REPORT (continued)

Board subcommittees

The challenge of limited capacity in the Board that was experienced during the year under review was felt more at subcommittee level. The subcommittees were nevertheless effective in enabling the Board to exercise oversight and give direction to the organisation.

The Audit and Risk Committee

The committee was chaired by an independent member and comprised four members, two of which were non-executive and two independent members. The committee operated under an approved Charter. The Chief Executive Officer, the Chief Financial Officer and internal and external auditors attended meetings of the committee by invitation.

The Human Resources Committee

The Human Resources Committee comprised four non-executive members, one of whom is the Chairperson. This committee was responsible for addressing most of the organisational issues, most of which are referred to in the Chairman's report. Owing to the number and complexities of these issues, the committee held an unprecedented number of special meetings. This situation will be addressed in the new financial year to reduce the number and time of meetings attended by committee members.

The Executive Committee

The Executive Committee comprises non-executive members and the CEO is convened on an urgent basis to deliberate and decide on urgent matters of the Board. There were no executive committee meetings during the year under review.

Disqualification of Armscor directors

None of Armscor's Board members are disqualified from serving as directors on any of the grounds contained in either the Companies Act, 1973 (as amended) or in the PFMA and its regulations.

Requirements in terms of the Protocol on Corporate Governance in the Public Sector

Organisational structure

The organisational structure of the Corporation appears on page 15 of this report.

Significant events reported to the Executive Authority

The cancellation of the Vistula Tender, more fully referred to in the Chairman's report, was reported to the Executive Authority during the year under review.

Litigation matters

During the reporting period Armscor was involved in two civil matters. In one matter Armscor instituted legal action for the recovery of damages suffered as a result of breach of contract. Judgment was handed down in favour of Armscor, after which the debtor made arrangements to pay the debt owed in instalments. In the second matter Armscor was involved in a dispute regarding the imposition of penalties. The matter was partly heard and arbitration proceedings are still continuing. A third matter that became evident after the year-end involves legal action instituted against Armscor in the civil court of Lisbon in Portugal. The matter involves a claim for the recovery of commission in the amount of about R2,5 billion in respect of a transaction which occurred during the late 1980s. Armscor was also involved in two labour disputes. One dispute emanated from an alleged constructive dismissal and the matter is proceeding at the CCMA. The other dispute was instituted by a trade union alleging unfair labour practice arising from the non-payment of performance bonuses. The matter has since been settled by the parties.

Armscor Business (Pty) Ltd was involved in two matters during the reporting period. In the one matter Armscor Business instituted a claim for the recovery of damages suffered as a result of unlawful occupation of its premises. Default judgement was handed down in favour of Armscor Business and the other party subsequently filed a rescission application. The matter will proceed in the normal course. In the second matter Armscor Business was served with summons for the recovery of damages allegedly suffered as a result of breach of contract. The matter is proceeding in the Northern Cape High Court.

Protocol for communication with shareholder

The Executive Authority for Armscor is the Minister of Defence, who represents the Shareholder. The Board as the Accounting Authority of the Corporation reports to the Minister of Defence. Communication with the shareholder is channelled primarily through the office of

DIRECTORS' REPORT (continued)

the Chairman. The Board had two formal meetings with the Shareholder during the year under review. In addition, ad hoc meetings were held between the Minister and the Chairman. Regular reporting was undertaken in terms of the Shareholder's Compact, and additional ad hoc reports were also submitted.

Going concern

During the previous reporting period it was reported that a process of transforming Armscor had started. This process continued during the period under review as discussed in the Chairman's and CEO reports. The directors, therefore, have no reason to believe that Armscor will not remain a going concern in the foreseeable future.

Post balance sheet events

As reflected in this report and financial statements, no material facts or significant circumstances which affect the financial position of this Corporation or group have arisen between the date of the balance sheet and the production date of this report.

Performance against goals

Operational Objectives for the 2007/08 Financial Year

The Armscor Three Year Integrated Corporate and Business Plan define fifteen Key Performance Indicators. The first nine of these Key Performance Indicators are directly linked to Armscor's functions as defined in the Armscor Act. The other Key Performance Indicators deal with corporate

governance, Armscor's black economic empowerment (BEE) initiative, which is in support of government BEE policy, the energy savings initiative and the transformation of Armscor to reflect the demographics of the country.

A three-year strategy was developed for each of the aforesaid Key Performance Indicators, with specific Performance indicators / goals for the 2007/08 financial year in each area.

Performance against goals

Armscor translates its operational objectives into strategic initiatives. These objectives are used to measure the performance of the Corporation.

An overall efficiency measure used by Armscor is the cost of acquisition. This measure reflects the ratio of acquisition cost versus the total of forecasted acquisition activities. A goal of 2,93% was set for the 2007/08 financial year. A result of 4,4% was achieved against actual, compared with 3,9% for the 2006/07 period. The goal for 2007/08 was not fully achieved, however, because the total acquisition activities was reduced with R3,359m due to extension of milestone deliveries on acquisition projects and requirements for R1,479m not received from the South African Defence Force.

Armscor's subsidiary companies experienced a loss of R8,0m of which Armscor Business (Pty) Ltd contributed R4,6m against a set target of R9,1m net income. The loss of the property companies amounts to R3,4m which consists of depreciation on buildings.

DIRECTORS' REPORT (continued)

Armcor's Key Performance Indicators and performance against set objectives are contained in the following table:

<i>Key Performance Indicator</i>	<i>Goal</i>	<i>Performance against Goal</i>
Objective 1: The Corporation must acquire defence matériel, facilities and services		
1.1 Establish and implement capability management model by 1 September 2007	Fully deploy capability management model by 1 September 2007	The first two phases of the capability management initiative are essentially complete. The integration of the system development with the business register has been completed and the rollout of the work authorization system is continuing well. This system now enables management to gain information on resource loading and allocation to all elements of the business. The next phase to define and generate job descriptions for all employees has commenced and is progressing well. It is planned that this phase will be completed in the next six months. Objective partially achieved
1.2 ARMSCOR is subjected to annual ISO 9001 audits. Zero significant audit findings allowed and ISO listing to be maintained at the end of each financial year	Maintain ISO 9001 listing by 2008-03-31	Scheduled internal audits according to the 3-year audit plan have been executed. No major findings were reported. Objective achieved
1.3 Establish Naval Ship Support Agency	Project to be operational by 2007-08-31	The Naval Ship Support Centre was initiated during April 2007 in Simon's Town Naval Base. Armcor representatives are in place and the first phase was established. Growth is ongoing and it is now regarded as a routine activity with ongoing monitoring. Objective achieved
Objective 2: The Corporation must establish a programme management system		
2.1 Improve tool to be integrated with DAPD Baseline Approval Data, Capability Management, Job Description and link to the tool to project document management system (SharePoint)	Work Authorisation Integrated System to be implemented 2008-03-31	An initial project management system was established utilising Microsoft Projects. For various reasons this system did not meet expectations and it has been replaced by the Acquisition Business Register based on Microsoft Office products coupled to an SQL database. Full implementation will only be achieved once the COMAS system is delivered. The Business Register system has been completed and extensions to it for Status Reporting and Works Authorisation and Intellectual Property Management have been completed and implementation and rollout is continuing well as mentioned under item 1.1. Objective partially achieved

DIRECTORS' REPORT (continued)

<i>Key Performance Indicator</i>	<i>Goal</i>	<i>Performance against Goal</i>
Objective 3: The Corporation must provide for a Quality Assurance Capability		
3.1 Accepted and approved Learnerships, by SETA, in the Quality Assurance environment in ARMSCOR	Implement Learnerships by 2008-03-31	The learnership has been submitted to the South African Qualifications Authority. The speed of the process is now determined by SAQA. Objective partially achieved
3.2 Establish baseline for Quality Assurance competency, develop and implement Competency Management Model	Implement competency management model by 2008-03-31	By the end of March 2008 the capability management model was developed and implemented according to plan. Objective achieved
Objective 4: The Corporation must dispose of defence matériel in consultation with the OEM¹		
4.1 Sales turn-over to be reached set at 90% of Sales Plan	90% of Sales Plan to be achieved by 2008-03-31. Target set at R123.7m and 90% is then R111.3m	The sales targets for the financial year, including the fourth and final quarter of 2007/08, were not achieved. As at the end of March 2008 DMD only achieved sales to a value of R16,4m. The balance of the forecasted sales did not realise due to changes imposed upon DMD regarding the sales approval process. This resulted in the delay of the Ratel 3 sale to Jordan to the value of R85m, and among others the Ratel vehicles sale to Senegal valued at R21m. Other influencing factors included the restrictions imposed by the DCAC on the sale of Samil vehicles, SANDF vehicles disposed of not being registered by the arms of service on NATIS prior to their disposal, and the donation of disposed stock by the DOD to the value of approximately R40m that had to be withdrawn from the DMD sales plan. Notwithstanding the circumstances DMD continued to work on its sales initiative by processing approximately 209 stock lists and 132 transfer lists received from the offices of the Chief of Logistics and Log Support Formation. NCACC approval was also received for the sale of 30 Ratel vehicles to Senegal through a local company Ivema to the value of R 17,5 m and NCACC approval of the sale of 20 Ratel vehicles to Jordan is awaited. Objective not achieved

DIRECTORS' REPORT (continued)

Key Performance Indicator	Goal	Performance against Goal
Objective 5: The Corporation must support, maintain and manage strategic and essential defence industrial capabilities, resources and technologies		
5.1 Take over the management of the NDS	<p>1. Management take-over by 2007-04-01</p> <p>2. Consolidation phase to be completed by 2008-03-31</p> <p>Staff take-over</p> <p>HR Processes and systems rollout</p> <p>Business plans update</p> <p>3. Reorganisation plan to be developed by 2008-03-31</p> <p>Commercialisation Plans and associated Business Plan to be developed by 2008-03-31</p>	<p>Transfer took place on 2007/09/01 (Scheduled transfer later as planned due to court interdict)</p> <p>Objective achieved</p> <p>Staff takeover on 1/9/2007</p> <p>Full support provided from Head Office, with local support at the Dockyard</p> <p>Induction process completed</p> <p>IT connectivity provided through IMT in the interim</p> <p>The business plan has been developed and is undergoing approvals. It incorporates the re-organisation plan</p> <p>Objective partially achieved</p> <p>A Memorandum of Understanding was entered into between MBDA and Armscor to develop a business plan for possible opportunities. The business plan has not been completed and the process is being reviewed as some of the key partners have withdrawn.</p> <p>Objective not achieved</p>
Objective 6: The Corporation must establish a Defence Industrial Participation Programme Management System		
6.1 Approval of DIP credits in line with Strategic Defence Packages and other acquisition contracts	R 1,226 billion credits to be approved by 2008-03-31	DIP credits amounting to R1,414 billion were approved Objective exceeded
Objective 7: Corporate Governance		
7.1 Armscor's external audit report to contain zero Audit Report Matters	Not more than three (3) Audit Report Matters after the final audit exercise by the Auditor-General.	<p>The Auditor General indicated that no material weaknesses were identified in the internal control systems.</p> <p>The Audit Report contained no significant matters identified by the External Auditors.</p> <p>Objective achieved</p>

DIRECTORS' REPORT (continued)

Key Performance Indicator	Goal	Performance against Goal
Objective 8: ARMSCOR strategic initiatives in support of national initiatives		
8.1 Increase Armscor's spending in respect of the Armscor operating budget and the SDA and GDA accounts on BEE companies	Operating Budget: 50% SDA & GDA: 25% Armscor Business: 40% of discretionary cost of sales	<p>Spending on Armscor's operating budget achieved 59,43% against a target of 50%. (Total purchases excluding parastatals is R36 756 462. The total spent on BEE companies was R21 845 998.)</p> <p>Objective exceeded</p> <p>Spending on the SDA and GDA accounts achieved 26,28% against a target of 25%. (The target refers to BEE expenditure as a percentage of total acquisition project expenditure. R1 169 421 731 is the net figure excluding SDPs, A400m, Maulstic, parastatals and multi-nationals for the quarter and the figure in respect of expenditure on BEE companies was R307 324 031.)</p> <p>Objective exceeded</p> <p>Spending by Armscor Business achieved 48.07% against a target of 40% of discretionary cost of sales and operating expenses. The target of 40% was based on discretionary cost of sales and operating expenses which amounted to R118 608 875 – net figure after taking out non- discretionary spending i.e. other Government departments, inter-departmental and foreign business. The BEE spent was R57 020 994 after deducting the amount spent through Infrastructure Division.</p> <p>Objective exceeded</p>
8.2 Execute energy savings plan	Conform 90% to energy savings plan by 31 March 2008	<p>The Cabinet approved an initiative to implement energy efficiency measures in public buildings under the control of the Government. The National Energy Efficiency Strategy has set a national energy savings target of 12% reduction in energy consumption by 2015. The energy efficiency target for 2006 until 2010 is a reduction of 1,2% per annum. The upgrading, replacement and intensified maintenance of the building systems started in October 2006. The plan was 100% executed which included the following initiatives:</p>

DIRECTORS' REPORT (continued)

Key Performance Indicator	Goal	Performance against Goal
		<ul style="list-style-type: none"> • An energy Management System was installed to manage energy demand (peak demand). • An air-conditioning management system has been installed and air-conditioning is switched off between 17:00 and 05:00. • Upgrading of 10 of the air-conditioning electronic control system units in the Armscor Building is completed. • 20 of the old chilled water control valves have been changed to modern types. • 5 New/modern pressure transducers (pump controllers) have been installed on the cooling system. • Lighting control was implemented by switching off office lights between 19:00 and 06:00 on weekdays and totally over weekends. (Recently lights have been switched off for a longer periods, between 18:00 and 06:00). • Time switches have been fitted to all lights in the gardens, parking areas and sport grounds, as well as in the lapa and Castle area. • Switching escalators on only from 07:00-08:00 and 16:00-17:00. <p>The impact of the energy savings initiatives executed resulted on average in a 6,9% reduction in maximum peak and 14,1% in energy consumption measured against the 2005 baseline.</p> <p>Objective achieved</p>

DIRECTORS' REPORT (continued)

Key Performance Indicator	Goal	Performance against Goal
Objective 9: ARMSCOR'S operational strategic objectives		
9.1 Improve the demographic profile of Armscor to reflect the national and regional demographic profile	<p>At least 80% of external appointments to be black</p> <p>At least 20% of external appointments in the technical functional groups to be women</p> <p>At least 65% of external appointments in the non-technical functional groups to be women</p> <p>At least 29% of employees in the supervisory levels and above to be women</p>	<p>90,91% of external appointees were black</p> <p>Objective exceeded</p> <p>20% of external appointees in the technical functional group were women.</p> <p>Objective exceeded</p> <p>63,83% of external appointees in the non-technical functional groups were women.</p> <p>Objective not achieved</p> <p>29,07% of employees in the STS (supervisory level) and above were women.</p> <p>Objective exceeded</p>
9.2 Bursaries	Grant bursaries to six tertiary level students in line with Armscor's strategic manpower plans	<p>Bursaries were granted to four students during the 2007/08 financial year.</p> <p>Objective partially achieved</p> <p>The bursar programme was reviewed and nine bursaries were awarded in April 2008.</p> <p>1 male (African) 8 females 4 African females 4 Indian females</p> <p>All bursaries were granted to students in engineering.</p>
9.3 Talent Development Programme	Have 12 trainees under the scheme	<p>A total of 15 people went through the Talent Development Pool programme during the 2007/08 financial year.</p> <p>Objective exceeded</p>

GROUP: FIVE YEAR REVIEW AT 31 MARCH 2008

	2008	2007	2006	2005	2004
	Rm	Rm	Rm	Rm	Rm
BALANCE SHEETS					
ASSETS					
Property, plant and equipment	203.3	197.9	194.6	200.2	206.7
Intangible assets	0.2	0.2	-	-	-
Other assets	30.0	35.0	-	-	-
Net current assets	281.1	237.5	218.0	197.6	195.2
	514.6	470.6	412.6	397.8	401.9
EQUITY AND LIABILITIES					
Ordinary shareholders' interest	514.6	470.6	412.6	397.8	401.9
INCOME STATEMENTS					
REVENUE					
Sale of goods	967.0	1,236.9	736.2	760.5	807.1
Allocation from the State budget for operating and technology expenditure	415.6	347.6	315.4	284.1	249.6
Interest received	35.7	25.7	19.7	21.7	26.9
Rental income	26.2	23.8	21.6	19.7	17.9
Other income	17.5	19.6	14.5	19.1	25.6
	1,462.0	1,653.6	1,107.4	1,105.1	1,127.1
SURPLUS/(DEFICIT) FOR THE YEAR	44.0	58.0	14.8	(4.1)	9.8
TOTAL VALUE OF ACQUISITION					
ACTIVITIES					
Special Defence Account	7,794.0	8,003.5	7,408.3	6,549.0	7,443.8
General Defence Account	807.3	832.1	834.0	728.5	783.0
Other	210.6	195.3	163.6	109.3	111.6
	8,811.9	9,030.9	8,405.9	7,386.8	8,338.4

GROUP VALUE ADDED STATEMENT

FOR THE YEAR ENDED 31 MARCH 2008

The statement shows the wealth the group has created through its acquisition, maintenance and disposal activities aimed at meeting the defence matériel requirements of South Africa as well as trading and investment operations. The statement shows how wealth was created and how it was disbursed amongst stakeholders, leaving a retained amount which was re-invested in the group for the replacement of assets, the development of operations and the maintenance of required capabilities.

	2008 Rm	%	2007 Rm	%
Revenue	1 462.0		1 653.6	
Sale of goods and services	967.0		1 236.9	
Government grant	415.6		347.6	
Rental income	26.2		23.8	
Other income	17.5		19.6	
Interest received	35.7		25.7	
Less: Paid to suppliers for materials and services	(962.3)		(1,220.3)	
TOTAL VALUE ADDED	499.7	100	433.3	100
DISTRIBUTED AS FOLLOWS:				
To employees as salaries, wages and other benefits	426.2	85	350.0	81
To Government as taxation	8.6	2	8.2	2
TOTAL VALUE ADDED DISTRIBUTED	434.8	87	358.2	83
Portion of value added reinvested to sustain and expand the business	64.9	13	75.1	17
TOTAL VALUE ADDED DISTRIBUTED AND REINVESTED	499.7	100	433.3	100
TAXATION				
Paid in taxes to Government	8.6		8.2	
• Regional Services Council Levies	-		0.3	
• Rates and taxes to local authorities	8.6		7.9	
Collected on behalf of, and paid over to Government	111.1		117.6	
• Employees taxation deducted from remuneration paid	79.6		83.5	
• Unemployment Insurance Fund	1.6		1.3	
• Net value added taxation (VAT)	29.9		32.8	

FINANCIAL RESULTS FOR THE YEAR ENDED 31 MARCH 2008

The following main aspects concerning the Armscor group's financial results are apparent from the annual financial statements.

BALANCE SHEET

The net value of group assets of R514,6 million shows an increase compared with the previous year's figure of R470,6 million. Investments and cash form a substantial part of the assets and are reserved to finance specific future obligations, the most important of these being the replacement of capital equipment.

INCOME STATEMENT

Revenue for the group declined to R1 462 million (2007: R1 653,6 million) for the financial year. Included in revenue was an amount of R415,6 million (2007: R347,6 million) which was received from the state in the form of a transfer payment. The increase in the allocation furthermore provided for an amount of R51,3 million in respect of the Naval Dockyard Simon's Town that Armscor took over on 1 September 2007.

The surplus of the group decreased by R14,0 million to R44 million for the year under review, compared with an increase of R43,2 million that resulted in a surplus of R58 million the previous year. The most significant reasons for the decrease in the surplus are as follows:

	2008	2007
	Rm	Rm
• Increase in Government allocation	68.0	32.2
Armscor	16.7	32.2
Naval Dockyard Simon's Town	51.3	-
• Increase in net operating expenditure of Armscor	(57.2)	(33.9)
Armscor	(11.4)	(33.9)
Naval Dockyard Simon's Town	(45.8)	-
• Increase in rental income	2.6	2.3
• (Decrease)/Increase in profit of subsidiaries	(35.8)	34.0
• Increase in net interest received	7.8	3.4
• (Decrease)/Increase in other income	0.6	5.2
NET (DECREASE)/INCREASE	(14.0)	43.2

The increase in the Government grant is to defray the cost of the group's operations for the year under review and to ensure that Armscor's contracted service delivery to the Department of Defence (DOD), in terms of the Service Level Agreement (SLA), is effectively and efficiently met. Armscor's operating expenditure was lower than what was budgeted for mainly due to concerted efforts to reduce cost and personnel appointments not materialising as planned, delays in appointments and savings on subsistence and travel as acquisition projects were delayed. The recognition of the surplus on post retirement medical benefits furthermore made a positive contribution to the surplus of the group.

The loss contributed by the subsidiaries for the year under review was R8,0 million compared to a surplus of R27,8 million for the previous year and is detailed as follows:

	2008	2007
	<i>Rm</i>	<i>Rm</i>
• (Loss)/Surplus from operations	(18.1)	19.9
• Net finance income	10.1	7.9
	(8.0)	27.8

The lower performance of Armscor Business (Pty) Ltd contributed to the decrease and was mainly due to the delay in the approval process with the disposal of surplus defence matériel which resulted in slower sales realisation. There was also a delay in placement of orders on Defence Institutes resulting in not enough time to deliver a full service in the current financial year. However, Gerotek and Alkantpan performed better than expected and the company managed to recover some of the losses incurred.

INCOME STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008

CORPORATION				GROUP	
2007	2008		NOTE	2008	2007
Rm	Rm			Rm	Rm
416.3	497.5	REVENUE	4	1,462.0	1,653.6
416.3	443.9	ARMSCOR OPERATING INCOME		423.3	398.5
-	53.6	NAVAL DOCKYARD SIMON'S TOWN OPERATING INCOME		53.6	-
-	-	SALES GENERATED BY SUBSIDIARIES		967.2	1,132.1
-	-	DEFENCE MATÉRIEL DISPOSAL		17.9	123.0
-	-	COST OF GOODS SOLD		(853.1)	(1,099.6)
-	-	SUBSIDIARIES		(839.2)	(1,002.1)
-	-	DEFENCE MATÉRIEL DISPOSAL		(13.9)	(97.5)
416.3	497.5	GROSS MARGIN		608.9	554.0
416.3	443.9	ARMSCOR CORPORATION		423.3	398.5
-	53.6	NAVAL DOCKYARD SIMON'S TOWN		53.6	-
-	-	SUBSIDIARIES		128.0	130.0
-	-	DEFENCE MATÉRIEL DISPOSAL		4.0	25.5
(378.3)	(435.5)	NET OPERATING EXPENDITURE		(564.9)	(496.0)
(378.3)	(389.7)	ARMSCOR CORPORATION		(379.1)	(368.3)
-	(45.8)	NAVAL DOCKYARD SIMON'S TOWN		(45.8)	-
-	-	SUBSIDIARIES		(120.9)	(108.4)
-	-	DEFENCE MATÉRIEL DISPOSAL		(19.1)	(19.3)
38.0	62.0	SURPLUS FROM OPERATIONS	5	44.0	58.0
38.0	54.2	ARMSCOR CORPORATION		44.2	30.2
-	7.8	NAVAL DOCKYARD SIMON'S TOWN		7.8	-
-	-	SUBSIDIARIES		7.1	21.6
-	-	DEFENCE MATÉRIEL DISPOSAL		(15.1)	6.2
(7.8)	(10.0)	FINANCE CHARGES	6	-	-
30.2	52.0	SURPLUS FOR THE YEAR		44.0	58.0

STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2008

	ORDINARY SHARE CAPITAL	GENERAL RESERVE	MARKETING PROMOTION RESERVE	CAPITAL AND BUILDING MAINTENANCE RESERVE	COMPUTER UPGRADING RESERVE	INTERNAL INSURANCE RESERVE	TOTAL
	Rm	Rm	Rm	Rm	Rm	Rm	Rm
CORPORATION							
Balance at 1 April 2006	75.0	227.4	9.5	22.6	15.0	23.8	373.3
Surplus for the year	-	30.2	-	-	-	-	30.2
Transfer to/ (from) reserves	-	(1.1)	0.2	-	-	0.9	-
Balance at 31 March 2007	75.0	256.5	9.7	22.6	15.0	24.7	403.5
Surplus for the year	-	52.0	-	-	-	-	52.0
Transfer to/ (from) reserves	-	(1.1)	0.4	-	-	0.7	-
Balance at 31 March 2008	75.0	307.4	10.1	22.6	15.0	25.4	455.5
GROUP							
Balance at 1 April 2006	75.0	263.4	9.5	25.9	15.0	23.8	412.6
Surplus for the year	-	58.0	-	-	-	-	58.0
Transfer to/ (from) reserves	-	(1.1)	0.2	-	-	0.9	-
Balance at 31 March 2007	75.0	320.3	9.7	25.9	15.0	24.7	470.6
Surplus for the year	-	44.0	-	-	-	-	44.0
Transfer to/ (from) reserves	-	(1.1)	0.4	-	-	0.7	-
Balance at 31 March 2008	75.0	363.2	10.1	25.9	15.0	25.4	514.6

All reserves are considered to be non-distributable. The reserves are required for the total net capital requirement of the group. Refer to accounting policy note 3.7 for the descriptions.

CASH FLOW STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm	NOTE	Rm	Rm
30.1	38.0	CASH FLOW FROM OPERATING ACTIVITIES:	49.0	39.4
390.7	461.9	Cash receipts from customers	1,417.4	1,627.9
(378.4)	(449.5)	Cash paid to suppliers and employees	(1,404.1)	(1,614.2)
12.3	12.4	Cash utilised by operations	13.3	13.7
(7.8)	(10.0)	Interest paid	-	-
25.6	35.6	Interest received	35.7	25.7
		CASH FLOW FROM INVESTING ACTIVITIES:		
(11.7)	(11.8)	Investment to maintain operations	(24.5)	(19.9)
(11.7)	(11.8)	Purchase of property, plant & equipment	(28.0)	(20.0)
-	-	Proceeds from disposal of property, plant & equipment	3.5	0.3
-	-	Intangible assets acquired	-	(0.2)
18.4	26.2	NET INCREASE IN CASH AND CASH EQUIVALENTS FOR THE YEAR	24.5	19.5
272.8	291.2	CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	288.0	268.5
291.2	317.4	CASH AND CASH EQUIVALENTS AT END OF YEAR	312.5	288.0

NOTES TO THE CASH FLOW STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
A CASH (UTILISED)/GENERATED BY OPERATIONS				
30.2	52.0	Surplus for the year	44.0	58.0
3.6	7.0	Adjustments for:	19.1	16.4
3.6	7.0	Depreciation	20.4	16.6
-	-	(Profit) on disposal of property, plant & equipment	(1.3)	(0.2)
7.8	10.0	Interest paid	-	-
(25.6)	(35.6)	Interest received	(35.7)	(25.7)
16.0	33.4	Operating surplus before working capital changes	27.4	48.7
(3.7)	(21.0)	Working capital changes	(14.1)	(35.0)
-	-	Decrease/(Increase) in other assets	5.0	(35.0)
(32.5)	(21.3)	(Increase)/Decrease in accounts receivable	(13.9)	8.0
-	0.1	Decrease/(Increase) in inventories	(4.5)	0.7
22.7	(3.9)	Increase/(Decrease) in short term loans	-	-
5.2	(21.4)	Increase/(Decrease) in accounts payable	(32.6)	(9.6)
0.9	25.5	Increase/(Decrease) in provisions	31.9	0.9
12.3	12.4		13.3	13.7
B CASH AND CASH EQUIVALENTS				
291.2	317.4	Cash on hand and balances with banks	312.5	288.0
24.7	25.4	Cash allocated to insurance reserve	25.4	24.7
266.5	292.0	Cash and cash equivalents	287.1	263.3

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

1. MANDATE

Armcor receives its mandate for the period under review from the Armaments Corporation of South Africa, Limited Act (Act No 51 of 2003) and the Armaments Corporation of South Africa, Limited Amendment Act (Act No 16 of 2005), which came into effect from 8 May 2006 by proclamation 20 published in Government Gazette 28779 of 5 May 2006 in terms of which the Corporation is empowered to meet:

- the defence matériel requirements of the Department of Defence (DOD) effectively, efficiently and economically; and
- the defence technology, research, development, analysis, test and evaluation requirements of the Department of Defence effectively, efficiently and economically.

The Act furthermore provides that Armcor must adhere to accepted corporate governance principles, best business practices and South African Statements of Generally Accepted Accounting Practice within a framework of established norms and standards that reflect fairness, equity, transparency, economy, efficiency, accountability and lawfulness.

2. FINANCIAL POLICY

Activities are financed as follows:

2.1 Armcor's operating funds

Armcor's operating funds are obtained via the defence budget and together with interest earned thereon are utilised to finance operating expenditure, the acquisition of fixed assets and expenditure for the creation and maintenance of facilities and services.

2.2 Operating capital and fixed capital of subsidiaries

Operating capital and fixed capital requirements of subsidiaries are financed from own income generated and cash allocated by the holding company, as well as additional funding received from the DOD if required.

2.3 Procurement of armaments

Armaments purchases and maintenance are financed by means of withdrawals from the Special Defence Account in terms of the Defence Special Account Act (Act No 6 of 1974, as amended) and the General Defence Account. Strategic Defence Packages are financed wholly or partially by means of draw downs against credit facilities supplied by National Treasury.

3. ACCOUNTING POLICY

The Corporation's year end is the same to those of subsidiaries. The principal accounting policies adopted by the group, are set out below:

3.1 Basis of preparation

The principal accounting policies of the group and disclosures made in the annual financial statements conform with South African Statements of Generally Accepted Accounting Practice and are consistent with those applied in the previous year except as follows:

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

The group has adopted the following new and amended IFRS standards during the year. Adoption of these revised standards did not have any effect on the financial performance of the group. They did however give rise to additional disclosures.

- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Amendment – Presentation of Financial Statements

The principal effects of these changes are as follows:

- IFRS 7 Financial Instrument Disclosure

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the group's financial instruments and the nature and extent of risks arising from those financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

- IAS 1 Presentation of Financial Statements

This amendment requires the group to make new disclosures to enable users of the financial statements to evaluate the group's objectives, policies and processes for managing capital. These new disclosures are shown in Note 23.

The financial statements have been prepared on a historical cost basis, except for some financial instruments that have been measured at fair value. The financial statements are presented in South African Rand and all values are rounded to the nearest million unless otherwise indicated.

New standards, amendments and interpretations not yet effective

The group has not applied various new standards and interpretations that have been issued, but which are not yet effective. These are as follows, excluding those that are not expected to apply to the group.

		<i>Effective date for year ends commencing after:</i>
IAS 1	Presentation of Financial Statements - Revised	2009-01-01
IAS 23	Borrowing Costs - Revised	2009-01-01
IAS 32	Amendments to IAS 32 Financial Instruments	2009-01-01

Revised IAS 1 – Presentation of financial statements

The main changes from the previous standard require that an entity must present:

- all non-owner changes in equity (that is, 'comprehensive income') either in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income);
- a statement of financial position (balance sheet) as at the beginning of the earliest comparative period in a complete set of financial statements when the entity applies an accounting policy retrospectively or makes a retrospective restatement;
- reclassification adjustments relating to components of other comprehensive income.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

IAS 23 – Borrowing costs

The amendments to IAS 23 require that borrowing costs that are directly attributable to the acquisition, construction and production of a qualifying asset must in future be capitalised. This statement is not expected to have any impact on the financial statements.

IAS 32 – Amendments to IAS 32 Financial Instruments

The principles in this standard complement the principles for recognising and measuring financial assets and financial liabilities in IAS 39 Financial Instruments: Recognition and Measurement, and for disclosing information about them in IFRS 7 Financial Instruments: Disclosures.

Except for additional disclosures in the financial statements, the adoption of these standards and amendments is not expected to materially affect the results of the financial position of the group.

3.2 Basis of consolidation

The group annual financial statements present the consolidated financial position and changes therein, operating results and cash flow information of the Corporation and its subsidiaries. Subsidiaries are those entities in which the group has an interest of more than one half of the voting rights or the power to exercise control so as to obtain benefits from their activities.

The results of subsidiaries are included for the duration in which the group exercises control over the subsidiary. All inter company transactions and resulting profits and losses between the group companies are eliminated on consolidation. The Corporation carries its investments in subsidiaries at cost less accumulated impairment losses in the financial statements.

3.3 Significant accounting judgements, estimates and assumptions

3.3.1 Judgements

In the process of applying the group's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the financial statements:

Plant and equipment utilised by contractors

The Corporation owns certain plant and equipment that are utilised by its contractors for the maintenance, manufacturing or supply of goods and services for the benefit of its clients. These assets are fully depreciated as the period of use varies between three and ten years. These assets are mainly kept for strategic purposes, therefore no adjustment has been made to their useful life.

Pension and other post employment benefits

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

The cost of defined post employment medical benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. (Further details are given in note 22)

Impairment of financial assets

In determining the impairment of financial assets management estimates the future cash flow as well as the appropriate discount rate. These estimates are based on the best available information at the balance sheet date.

Impairment of non-financial assets

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

3.4 Property, plant and equipment

3.4.1 Land and buildings

3.4.1.1 Buildings on freehold land

Land is stated at cost and is not depreciated. Buildings are stated at cost less accumulated depreciation and accumulated impairment. Depreciation is calculated on a straight line basis over the useful life of the buildings over periods that vary between twenty and fifty years.

3.4.1.2 Buildings on State property

Buildings are stated at cost less accumulated depreciation and accumulated impairment. Depreciation is calculated on a straight line basis over the useful life of the assets which is estimated as fifty years.

3.4.1.3 The buildings' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

3.4.2 Plant and equipment (including plant, machinery, equipment, office equipment, furniture, computers, vehicles and vessels)

Plant and equipment is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment. The cost of replacing part of such plant and equipment is capitalised when that cost is incurred if the recognition criteria is met. Depreciation is calculated to write off the cost of capitalised fixed assets on a straight line basis over their expected useful lives over periods that vary between three and ten years.

3.4.3 An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognising of the asset

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

(calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

- 3.4.4 The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

3.5 Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Gains or losses arising from derecognising of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised. Amortisation is calculated to write off the cost of capitalised intangible assets on a straight line basis over their expected useful lives over ten years.

Patents

The patents have been granted for periods ranging from ten to fifteen years respectively.

3.6 Inventories

Inventories are stated at the lower of cost (purchase cost) and net realisable value. Raw materials are calculated using the first in, first out method, except in the case of Hazmat Protective Systems where it is calculated at weighted average. Write downs to net realisable value and inventory losses are expensed in the period in which the write down or losses occur. Finished goods and work in progress are stated at actual cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

3.7 Non-Distributable reserves

All reserves are considered to be non-distributable. The full share capital and reserves are required for the total net capital requirement of the group. Cash is therefore retained to meet future commitments, and is consequently not available for the distribution of dividends.

Capital and building maintenance reserve

The reserve was established for comprehensive upgrading and replacement of obsolete capital equipment and maintenance of major building systems.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

Computer upgrading reserve

The purpose of this reserve is for the upgrading and replacement of obsolete, outdated computer technology.

Marketing promotion reserve

The reserve was established for the financing of exhibition costs in order to promote the local weapons industry which is part of Armscor's mandate, but which is not provided for via the transfer payment from the Department of Defence.

Internal Insurance Reserve

Self-insurance has been instituted where the cost-to-benefit relationship exceeds the risk and the incidence of losses is of a minor and infrequent nature. Self-insured risks are reviewed annually to ensure cover is adequate and an amount is held in an internal insurance fund to cover these risks.

3.8 Foreign currency conversion

Transactions and balances

Transactions denominated in foreign currencies are converted at the rate of exchange ruling at the transaction date. Monetary items denominated in foreign currencies are converted at the rate of exchange ruling at the balance sheet date. Gains or losses arising on conversion are recognised in the income statement.

3.9 Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be reliably measured. Revenue is measured at the fair value of consideration receivable or received. The following specific recognition criteria also needs to be met before revenue is recognised:

Sale of goods and services

Revenue comprises net invoiced sales to customers excluding VAT and all discounts. Sales are recognised at the date of delivery of goods or services, when significant risks and rewards of ownership are transferred to the buyer.

Interest income

Interest is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the group.

Dividends

Dividends are recognised when the right to receive payment is established.

Rental income

Rental income arising on properties is accounted for on a straight-line basis over the lease terms on ongoing leases.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

Government grant

Armcor's operating funds are obtained via the defence budget and recognised as a grant as and when received and together with interest earned thereon are utilised to finance operating expenditure, the acquisition of fixed assets and expenditure for the creation of facilities and services.

3.10 Insurance and risk management

The insurance and risk management policies adopted by the Armcor group are aimed at obtaining sufficient cover at the minimum cost to protect its asset base, earning capacity and legal obligations against unacceptable losses.

All fixed assets are insured at current replacement value. Risks are identified and insured while paying specific attention to the specialised nature of the group's various activities and exposures. Self-insurance has been instituted where the cost-to-benefit relationship exceeds the risk and the incidence of losses is of a minor and infrequent nature. Self-insured risks are reviewed annually to ensure cover is adequate. An amount of R25,4 million (2007: R24,7 million) is held in an internal insurance fund to cover these risks. This amount is disclosed as part of non-distributable reserves in the balance sheet. No major losses were experienced during the year under review. Claims of a general nature were adequately covered.

3.11 Financial instruments

Financial assets and liabilities are recognised on the group's balance sheet when it becomes a party to the contractual provisions of the instrument.

3.11.1 Measurement

Financial instruments are initially measured at fair value, which includes transaction costs that are directly attributable to acquisition or issue of the financial asset. Subsequent to initial recognition these instruments are measured as set out below.

3.11.1.1 Investments

Fixed deposits with a maturity date greater than three months are classified as held to maturity investments.

3.11.1.2 Loans and other receivables

Loans and other receivables are non-derivative assets that arise from transactions with providers. Subsequent to initial recognition, they are measured at cost less impairment provision. Provision for impairment of other receivables is established when there is objective evidence that the group will not be able to collect all amounts due according to the original terms of the receivables. Bad debts are written off when identified.

Personal loans are interest bearing over periods that vary between one and twelve months in terms of conditions of employment.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

3.11.1.3 Cash and cash equivalents

Cash and cash equivalents which are regarded as loans and other receivables are measured at amortised cost, based on the relevant exchange rates at balance sheet date.

For the purpose of the cash flow statement, cash and cash equivalents comprise of cash on hand, deposits held on call and investment instruments, all of which are readily convertible (within 3 months) to cash, available for use by the group unless otherwise stated and are subject to an insignificant risk of change in value.

3.11.1.4 Financial liabilities

After initial recognition, financial liabilities are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

3.11.1.5 Financial guarantees

Financial guarantees issued are carried at fair value. The fair value would be determined as the present value of future cash flows to settle the liabilities.

3.11.2 Derecognition of financial assets and liabilities

3.11.2.1 Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where the rights to receive cash flows from the asset have expired.

3.11.2.2 Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

3.11.2.3 Gains and losses

The difference in the respective carrying amounts on the derecognition of financial assets and liabilities is recognised in the income statement.

3.11.2.4 Financial guarantees

Financial guarantees issued are derecognised when the obligations under the liability are discharged.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

3.11.3 Impairment of financial assets

Financial assets carried at amortised cost

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

If there is objective evidence that an impairment loss has been incurred on a financial asset, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial assets original effective interest rate. The amount of the impairment shall be recognised in the income statement.

When a receivable is uncollectible, it is written off against the related provision for impairment. Such receivables are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

3.12 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 economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the income statement, net of any reimbursement.

Performance remuneration

The payment of performance remuneration is subject to the Corporations' achievement of set performance criteria. The Corporation use the Balanced Score Card method for evaluating individual performance. Performance remuneration is based proportionally on the individual performance as measured and expressed by the individual's performance score and also on Armscor department's performance as measured and expressed by their calculated performance score.

Provision for leave

Provision is calculated on leave days outstanding at end of year multiplied by remuneration rate based on the applicable remuneration package of each employee.

Provision for bonus

The provision for bonus which form part of the guaranteed annual package is for the period December to March of the applicable financial year and is calculated on the total annual remuneration package.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

3.13 Retirement benefits

The group contributes towards and operates the Armscor Defined Contribution Pension Fund and the Armscor Provident Fund, which offer benefits based on the contributions of and on behalf of every member, as well as on investment yields.

The group also provides post-retirement health care benefits to its retirees. The entitlement to post-retirement health care benefits is based on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. Valuations of these obligations are carried out by independent qualified actuaries. The cost of providing benefits under the defined benefits plan is determined using the projected unit credit actuarial valuation method.

Actuarial gains or losses in respect of defined benefit plans are recognised as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

- 10% of the present value of the defined benefit obligation at that date before deducting plan assets, and
- 10% of the fair value of any plan assets at that date.

The amount recognised is the excess determined above, divided by the expected average remaining working lives of the employees participating in that plan.

Where the group is in the net asset position, the defined benefit surplus is measured at the lower of:

- The present value of defined obligation, plus actuarial gains, less past service cost, less the fair value at balance sheet date of the plan assets; and
- The total of cumulative unrecognised actuarial loss, and past service cost and the present value of any economic benefits in the form of refunds from the plan or a reduction in future contributions of the plan.

3.14 Discontinued operations

A discontinued operation is a component of the group's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the comparative period.

3.15 Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
- b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

- c) There is a change in the determination of whether fulfilment is dependant on a specified asset; or
- d) There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b).

Leases of assets to the group under which all the risks and benefits of ownership are effectively retained by the lessor, are classified as operating leases. Payments made under operating leases are charged against income on a straight line basis over the period of the lease.

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee.

3.16 Research and development costs

Research cost are expensed as incurred. Development expenditure on an individual project is recognised as an intangible asset when the group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the asset and the ability to measure reliably the expenditure during development.

3.17 Impairment of tangible and intangible assets

The carrying amounts of assets mentioned in the accounting policy notes are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount is estimated as the higher of fair value less cost to sell and value in use.

Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

A previously recognised impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised in prior years.

3.18 Fruitless and wasteful expenditure

Fruitless and wasteful expenditure means expenditure which was made in vain as well as penalties levied on late deliveries and would have been avoided had reasonable care been exercised.

3.19 Borrowing costs

Borrowing costs are recognised as an expense when incurred.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		4 REVENUE		
-	-	Sale of goods and services	967.0	1,236.9
347.6	415.6	Government grant (Allocation from the State budget for operating and technology expenditure)	415.6	347.6
347.6	364.3	- Armscor Operational Income	364.3	347.6
-	51.3	- Naval Dockyard Simon's Town Operational Income	51.3	-
25.6	35.6	Interest received	35.7	25.7
25.6	34.2	- Armscor Operational Income	24.2	17.8
-	1.4	- Naval Dockyard Simon's Town Operational Income	1.4	-
-	-	- Subsidiaries	10.1	7.9
26.4	29.0	Rental income	26.2	23.8
16.7	17.3	Other Income	17.5	19.6
16.7	16.4	- Armscor Operational Income	8.6	9.3
-	0.9	- Naval Dockyard Simon's Town Operational Income	0.9	-
-	-	- Subsidiaries	8.0	10.3
416.3	497.5		1,462.0	1,653.6
		5 SURPLUS FROM OPERATIONS		
		Is arrived at after taking into account		
206.0	240.6	Salaries, wages and other benefits	376.3	304.6
30.3	35.1	Post Retirement Benefits	49.9	45.4
37.3	38.7	Subsidiary support (Transfer payment to Armscor Business)	-	-
8.3	6.7	Rent paid for machinery and equipment	7.5	9.1
0.9	1.0	Auditors' remuneration	1.7	1.4
0.9	1.0	Audit	1.5	1.4
-	-	Other services	0.2	-
3.6	7.0	Depreciation and fixed assets written off on acquisition (see note 8.7)	20.9	17.2
-	-	Net foreign exchange gain	(4.4)	(6.2)
-	-	Profit from disposal of property, plant & equipment	(1.3)	(0.2)
		6 FINANCE CHARGES		
7.8	10.0	Interest paid to subsidiaries	-	-
		7 TOTAL VALUE OF ACQUISITION ACTIVITIES		
		Government grants for operating expenditure are obtained to undertake acquisition actions. In accordance with Armscor's mandate, acquisition was undertaken on behalf of the following organisations:		
8,003.5	7,794.0	Special Defence Account	7,794.0	8,003.5
832.1	807.3	General Defence Account	807.3	832.1
175.9	108.6	SA Police Service	108.6	175.9
19.4	102.0	Other	102.0	19.4
9,030.9	8,811.9		8,811.9	9,030.9

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		8		
		PROPERTY, PLANT AND EQUIPMENT		
-	-	8.1	12.7	12.7
		Land		
-	-	Cost	12.7	12.7
-	-	Accumulated depreciation	-	-
-	-	8.2	138.4	143.7
		Buildings		
-	-	Cost	191.6	192.2
-	-	Accumulated depreciation	(53.2)	(48.5)
-	-	8.3	11.2	8.5
		Plant, machinery, equipment		
6.0	5.9	Cost	35.6	30.5
(6.0)	(5.9)	Accumulated depreciation	(24.4)	(22.0)
18.8	23.6	8.4	33.2	25.4
		Office equipment, furniture & computers		
39.0	50.2	Cost	75.8	58.5
(20.2)	(26.6)	Accumulated depreciation	(42.6)	(33.1)
0.7	0.7	8.5	7.8	7.6
		Vehicles & vessels		
1.6	1.6	Cost	17.9	15.2
(0.9)	(0.9)	Accumulated depreciation	(10.1)	(7.6)
19.5	24.3		203.3	197.9

Included in land and buildings is the IMT building erected on leasehold premises with a net book value of R4,33 million (2007: R4,45 million). The leasehold premises comprises a portion in extent 1,4475 ha of Erf 3779 in Simon's Town which is leased from the Department of Public Works. Detail pertaining to land and buildings is available at the registered office of the Corporation.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

8.6 RECONCILIATION OF CARRYING AMOUNT

	<i>LAND</i>	<i>BUILDINGS</i>	<i>PLANT, MACHINERY & EQUIPMENT</i>	<i>OFFICE EQUIPMENT, FURNITURE & COMPUTERS</i>	<i>VEHICLES & VESSELS</i>	<i>TOTAL</i>
	<i>2008</i>					
CORPORATION	RM	RM	RM	RM	RM	RM

Net book value				23.6	0.7	24.3
Opening balance	-	-	-	18.8	0.7	19.5
Additions	-	-	-	11.7	0.1	11.8
Assets written off/realised	-	-	-	-	-	-
Depreciation	-	-	-	(6.9)	(0.1)	(7.0)

	<i>2007</i>					
Net book value	-	-	-	18.8	0.7	19.5
Opening balance	-	-	-	10.6	0.8	11.4
Additions	-	-	-	11.7	-	11.7
Assets written off/realised	-	-	-	-	-	-
Depreciation	-	-	-	(3.5)	(0.1)	(3.6)

	<i>2008</i>					
GROUP	RM	RM	RM	RM	RM	RM
Net book value	12.7	138.4	11.2	33.2	7.8	203.3
Opening balance	12.7	143.7	8.5	25.4	7.6	197.9
Additions	-	1.2	5.3	18.4	3.1	28.0
Assets written off/realised	-	(1.6)	-	(0.5)	(0.1)	(2.2)
Depreciation	-	(4.9)	(2.6)	(10.1)	(2.8)	(20.4)

	<i>2007</i>					
Net book value	12.7	143.7	8.5	25.4	7.6	197.9
Opening balance	12.7	146.7	10.4	15.6	9.2	194.6
Additions	-	1.8	2.1	15.5	0.6	20.0
Assets written off/realised	-	-	-	-	(0.1)	(0.1)
Depreciation	-	(4.8)	(4.0)	(5.7)	(2.1)	(16.6)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		8.7 Depreciation and assets written off		
3.6	7.0	Buildings, installations, machinery, equipment and vehicles	20.4	16.6
-	-	Assets written off on acquisition	0.5	0.6
3.6	7.0		20.9	17.2
		8.8 Other matters		
		Included in the Corporation's value of plant, machinery and equipment are assets at contractors with a cost of R5,9 million (2007: R6,0 million) that are fully depreciated.		
		9 INTANGIBLE ASSETS		
-	-	Patents at cost	0.2	0.2
-	-	Accumulated depreciation	-	-
-	-		0.2	0.2
		Reconciliation of carrying amount		
-	-	Additions	-	0.2
		10 OTHER ASSETS		
-	-	Long term receivables	35.2	37.8
-	-	Less: Short term portion, shown as accounts receivable (note 13)	5.2	2.8
-	-		30.0	35.0
		The long term receivables are non-interest bearing. The repayment terms are as follows:		
		10/07/2009 R5 million		
		12/07/2010 R10 million		
		11/07/2011 R15 million		
		Refer to note 23 for fair value.		
		11 INVESTMENT IN SUBSIDIARIES		
-	-	Shares at cost	-	-
236.5	236.6	Loans to subsidiaries	-	-
236.5	236.6		-	-

Mutually agreed interest-bearing, unsecured loans without fixed conditions of repayment.

Included in the loans to subsidiaries are the loans of Armscor's property companies of which companies all income and expenses (if any) are reflected in the financial statement of the Corporation.

The carrying amount of the investments approximates its fair value.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

11. INVESTMENT IN SUBSIDIARIES (Continued)

SOUTH AFRICAN SUBSIDIARIES (At 100% Holdings)	ISSUED SHARE CAPITAL	SHARES AT COST		LOANS DUE BY SUBSIDIARIES	
		2008 R	2007 R	2008 Rm	2007 Rm
ARMSCOR BUSINESS (PTY) LTD	4,000	4,000	4,000	97.5	97.5
ERASMUSRAND PROPERTIES (PTY) LTD	1	1	1	136.0	135.9
INSTITUTE FOR MARITIME TECHNOLOGY (PTY) LTD*	4	4	4	-	-
OVERBERG TOETSBAAN (PTY) LTD**	5	5	5	-	-
OOSPARK (PTY) LTD	1	1	1	1.1	1.1
SPORTRAND (PTY) LTD	1	1	1	2.0	2.0
	4,012	4,012	4,012	236.6	236.5

*Dormant Subsidiary

** Deregistered 05/05/2008

The attributable interest of the Corporation in the net loss of its subsidiaries amounted to R8,0 million (2007 : surplus R27,8 million)

CORPORATION			GROUP	
2007 Rm	2008 Rm		2008 Rm	2007 Rm
12 INVENTORIES				
-	-	Raw materials	0.4	0.7
-	-	Work in progress	4.7	0.6
0.8	0.7	Consumables	1.5	0.8
-	-	Finished goods	0.2	0.2
0.8	0.7		6.8	2.3

The amount of write-down of inventories to net realisable value and all losses of inventory during the year is R Nil (2007: R Nil)

The amount of inventories written off during the year is R0,5 million (2007: R0,2 million)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		13. ACCOUNTS RECEIVABLE		
30.3	24.8	Financial assets	99.3	106.2
-	1.1	Trade receivables	71.1	70.7
-	-	Short term portion of long term receivables (note 10)	5.2	2.8
-	-	Other	34.4	27.5
-	1.1	Related parties	31.5	40.4
24.8	2.4	Other receivables	6.7	29.7
0.1	0.2	Personnel loans	0.4	0.4
2.0	3.1	Interest receivable on investments	3.1	2.0
3.4	18.0	Related parties other	18.0	3.4
		Non-financial assets		
21.9	48.7	Surplus on post-retirement medical benefit	54.3	33.5
52.2	73.5		153.6	139.7
		As at 31 March the aging analysis of trade receivables before allowance for doubtful debts are as follows:		
0.8	1.1	Neither past due nor impaired	45.9	40.1
		Past due but not impaired:		
0.8	1.1	30 - 60 days	15.3	25.4
0.8	1.1	60 - 90 days	4.0	1.6
0.8	1.1	90 - 120 days	8.8	1.3
10.8	20.8	120 days	50.4	42.6
14.0	25.2	Total	124.4	111.0
		Neither past due nor impaired relates to goods and services. Management has made an assesment and that they concluded that there are no indications of impairment.		
		Movement in the allowance for doubtful debts:		
4.4	14.0	Balance at the beginning of the year	40.3	26.7
9.6	10.1	Impairment losses recognised on receivables	10.3	10.0
-	-	Foreign currency translation adjustment	2.8	3.7
-	-	Amounts recovered during the year	(0.1)	(0.1)
14.0	24.1	Balance at the end of the year	53.3	40.3

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

Terms and conditions of the above financial assets:

Trade receivables are non-interest bearing and are generally on thirty to ninety days terms.

Other receivables are non-interest bearing and have an average term of six months.

Surplus on post-retirement medical benefit, refer to note 22.2.

Personal loans are interest bearing over periods that vary between one to twelve months in terms of terms and conditions of employment.

Interest is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the group.

For terms and conditions relating to related party receivables, refer to note 28.

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		14 CASH AND CASH EQUIVALENTS		
23.6	4.4	Cash at banks and in hand	(0.5)	20.3
267.6	313.0	Short-term deposits	313.0	267.7
<u>291.2</u>	<u>317.4</u>		<u>312.5</u>	<u>288.0</u>
		Included in cash and cash equivalents is an amount of R25,4 million (2007: R24,7 million) in respect of cash allocated to the insurance reserve.		
		Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and six months depending on the immediate cash requirements of the group, and earn interest at the respective short-term deposit rates.		
		15 SHARE CAPITAL		
		Authorised		
1,000	1,000	1 000 000 000 ordinary shares of R1 each	1,000	1,000
		Issued to the State		
<u>75.0</u>	<u>75.0</u>	75 000 000 shares at R1 per share	<u>75.0</u>	<u>75.0</u>

Share Capital is under the control of the executive authority.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
		16 SHORT TERM LOAN		
108.9	105.1	LOAN FROM SUBSIDIARY: ARMSCOR BUSINESS (PTY) LTD	-	-
		The short term loan represents the current account which is utilised to manage the overall cash flow of the group. This loan is unsecured, interest bearing and repayable on demand. The rate of interest levied is based on the rate of return earned by Armscor on surplus funds.		
		The carrying amount of the short term loan approximates its fair value.		
		17 ACCOUNTS PAYABLE		
		Financial liabilities		
11.8	11.6	Trade payables	32.5	36.5
27.8	4.5	Other payables	22.4	22.1
-	2.1	Related parties	37.1	66.0
39.6	18.2		92.0	124.6
		The table below summarises the maturity profile of the Group's financial liabilities based on undiscounted payments:		
39.6	18.2	Current	81.2	122.8
11.8	11.6	Trade payables	56.7	84.7
27.8	6.6	Other payables	24.5	38.1
-	-	< 30 Days	6.4	1.6
-	-	Trade payables	6.4	1.6
-	-	Other payables	-	-
-	-	> 60 Days	4.4	0.2
-	-	Trade payables	4.4	0.2
-	-	Other payables	-	-
39.6	18.2		92.0	124.6

Terms and conditions of the above financial liabilities:

Trade payables are non-interest bearing and are normally settled on thirty day terms.

For terms and conditions relating to related parties, refer to note 28.

The carrying amount of the accounts payable approximates its fair value.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

18. PROVISIONS

CORPORATION	PROVISION FOR BONUSES	PROVISION FOR LEAVE	PROVISION FOR PERFORMANCE REMUNERATION	TOTAL
	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Balance at 1 April 2006	4.4	28.9	14.0	47.3
Provisions made during the year	4.7	8.2	15.3	28.2
Provisions utilised during the year	(4.4)	(8.9)	(14.0)	(27.3)
Balance at 31 March 2007	4.7	28.2	15.3	48.2
Provisions made during the year	7.5	15.8	17.0	40.3
Provisions utilised during the year	(4.7)	(10.1)	-	(14.8)
Balance at 31 March 2008	7.5	33.9	32.3	73.7

GROUP	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Balance at 1 April 2006	6.3	39.9	20.8	67.0
Provisions made during the year	10.9	11.5	22.2	44.6
Provisions utilised during the year	(10.6)	(12.3)	(20.8)	(43.7)
Balance at 31 March 2007	6.6	39.1	22.2	67.9
Provisions made during the year	14.2	19.1	24.4	57.7
Provisions utilised during the year	(11.2)	(14.6)	-	(25.8)
Balance at 31 March 2008	9.6	43.6	46.6	99.8

Performance remuneration for 2006/07 that was under dispute will be paid end of July 2008 where as performance remuneration for 2007/08 will be paid after performance evaluation.

CORPORATION			GROUP	
2007	2008		2008	2007
<i>Rm</i>	<i>Rm</i>		<i>Rm</i>	<i>Rm</i>
432.8	483.8	19 CONTRACTUAL LIABILITIES		
		Projected outstanding commitments in respect of orders placed for expected deliveries	483.8	432.8
		Contractual commitments which may arise out of these contracts are covered in full by means of financial authorisations. In other cases cover is obtained by means of back-to-back orders amounting to R425,0 million (2007: R368,3 million)		
-	-	20 CAPITAL COMMITMENTS		
		Capital expenditure approved but not yet contracted for plant and equipment	-	-

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

21. CONTINGENT LIABILITIES

21.1 Guarantees

21.1.1 Bank guarantees have been issued for Armscor Business in favour of a local contractor amounting to R1,1 million (2007: R1,1 million) in respect of marketing transactions and for Armscor to a foreign contractor amounting to USD 2,1 million (2007: USD 1,0 million) for an advance payment received.

21.1.2 Bank guarantees have been issued on behalf of Armscor Business in favour of the South African Revenue Services: Customs and Excise and other creditors amounting to R13,5 million (2007: R11,1 million) with regard to local guarantees.

21.2 Other

At 31 March 2008 the group had a contingent liability in respect of rehabilitation of the test range at Alkantpan.

In terms of the National Environmental Management Act (Act 107 of 1998), section 28 (1) which came into effect on 29 January 1999, Alkantpan must take reasonable steps to avoid, stop or minimize degradation of the environment. The following options were investigated during the previous financial year, using reputable companies specialising in this field:

- Closing down and clearing

Alkantpan will be responsible for the initial phase where after a contractor will do the clearing. Estimated cost would have been R48,3 million and it would take an estimated seven years.

- Clearing with continued operations

This option would cause a huge loss of income as areas of the range would have to be closed for clearing operations resulting in clients requirements not being met.

- Fencing affected areas

The affected area would be fenced off, maintained and a trust fund established to cover the risk. The estimated cost would have been R16,8 million.

- Manage the range in compliance with the Act

To form a steering committee with Government in order to ensure legislative and ecological compliance with the Act, with no additional cost implication.

As no intention currently exists to cease activities at Alkantpan, Alkantpan has elected to manage the range in compliance with the Act and to continue with its day to day clearing actions. During the period under review, the steering committee which was formed between Alkantpan and the Department of Tourism, Environment and Conservation continued to guide and advise Alkantpan on the environmental way forward and to ensure legislative compliance to the Act.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

21.3 Operating lease commitments – Group as lessee

The group has entered into operational leases on certain motor vehicles and items of machinery and equipment. These leases have an average life of between 1 and 10 years. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 March 2008 are as follows:

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
3.9	0.3	Within one year	1.7	4.8
0.4	0.1	After one year but not more than five years	4.5	3.6
-	-	After five years	8.8	5.4
4.3	0.4		15.0	13.8

22. RETIREMENT BENEFITS

22.1 Pension and provident schemes

The group contributes towards and operates the Armscor Defined Contribution Pension Fund and Provident Fund, which offer benefits based on the contributions by and made on behalf of every member as well as investment yields. At the time of establishment of the Armscor Defined Contribution Pension Fund, Armscor guaranteed pensioners that were transferred from the previous pension fund to the current pension fund to receive a pension at least equal to the pension received in terms of the previous fund. Armscor's liability in this regard for the remaining 18 members is Nil (2007 : Nil) as the pensioners account in the pension fund is sufficiently funded.

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
20.0	24.4	The amount of contributions to the above scheme	34.1	29.4
20.0	24.4	The total amount expended during the year	34.1	29.4

22.2 Post-retirement medical benefits

The group also provides post-retirement health care benefits to their retirees. The entitlement to post-retirement health care benefits is based on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. Valuations of these obligations are carried out by independent qualified actuaries. In the 2006/07 valuation the closing plan assets were divided between the two units in the same proportion as the opening plan assets. In the 2007/08 valuation closing plan assets were divided in the same proportion as the closing liabilities.

The IAS19 (AC116) valuation of the group's post-employment benefits was carried out at 31 March 2008. Based on the latest projection performed at 31 March 2008 the present value of the obligation is R262,0 million (2007: R239,7 million) and the fair value of plan assets is R384,6 million (2007: R340,0 million).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION	2008	2007	2006	2005	2004
	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Present value of funded obligations	216.2	194.3	162.4	117.5	108.5
Fair value of plan assets	(317.4)	(267.9)	(209.5)	(148.8)	(112.0)
Present value of plan assets in excess of obligations	(101.2)	(73.6)	(47.1)	(31.3)	(3.5)
Unrecognised transitional liability	-	-	-	(5.1)	(10.1)
Unrecognised actuarial gains	48.8	47.3	34.8	30.8	9.5
Unrecognised past service gains	3.7	4.4	5.1	5.8	6.5
Net asset in balance sheet	(48.7)	(21.9)	(7.2)	0.2	2.4

GROUP	Rm	Rm	Rm	Rm	Rm
Present value of funded obligations	262.0	239.7	199.4	148.3	135.9
Fair value of plan assets	(384.6)	(340.0)	(263.2)	(184.3)	(135.6)
Present value of plan assets in excess of obligations	(122.6)	(100.3)	(63.8)	(36.0)	0.3
Unrecognised transitional liability	-	-	-	(6.0)	(11.9)
Unrecognised actuarial gains	63.3	60.8	43.7	34.2	7.3
Unrecognised past service gains	5.0	6.0	7.0	8.0	8.6
Net asset in balance sheet	(54.3)	(33.5)	(13.1)	0.2	4.3

Reconciliation of the present value of the funded obligations (Group)

	GROUP	
	2008	2007
	<i>Rm</i>	<i>Rm</i>
Opening balance	239.8	199.4
Current service cost (includes interest to year end)	9.8	6.4
Interest cost	18.3	14.6
Expected employer benefit payments	(6.0)	(5.3)
Expected closing balance	261.9	215.1
Actuarial (gain)/loss	0.1	24.6
Actual closing balance	262.0	239.7

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
Reconciliation of net liability in the balance sheet and amounts recognised in the income statement				
(7.2)	(21.9)	Opening balance	(33.5)	(13.1)
(3.4)	(15.8)	Expense recognised in employee remuneration costs	(4.4)	(3.8)
(5.1)	(5.6)	Employer benefit payments	(5.9)	(5.4)
(10.9)	(10.7)	Employer prefunding contributions	(15.8)	(15.9)
4.7	5.3	Payments from plan assets	5.3	4.7
(21.9)	(48.7)	Closing balance	(54.3)	(33.5)
Net benefit expense (recognised in employee remuneration costs)				
4.3	6.4	Current service cost	9.8	6.4
11.9	14.8	Interest cost	18.3	14.6
(17.8)	(23.4)	Expected return on plan assets	(29.7)	(22.4)
(1.1)	(1.4)	Actuarial (gain) recognised	(1.8)	(1.4)
(0.7)	(0.7)	Past service loss recognised	(1.0)	(1.0)
-	4.5	Transfer of liability from Armscor to Armscor Business	-	-
-	(6.7)	Transfer of assets iro liability transferred from Armscor to Armscor Business	-	-
-	(9.3)	Rebalancing of assets between Armscor and Armscor Business	-	-
(3.4)	(15.8)		(4.4)	(3.8)
Reconciliation of change in plan assets				
209.5	267.9	Fair value of assets at beginning of year	340.0	263.2
61.3	49.1	Actual return on assets	40.4	76.2
10.3	10.7	Contributions	15.8	16.0
(4.7)	(5.3)	Benefits paid	(5.3)	(4.7)
(8.5)	(5.0)	Other expenses	(6.3)	(10.7)
267.9	317.4	Fair value of assets at end of year	384.6	340.0

The main actuarial assumptions are:

	2008	2007
Discount rate	9,25%	7,75%
Health care cost inflation	8,25%	6,75%
Average retirement age	60,0	60,0
Expected return on plan assets	10,25%	8,5%

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

A one percentage point change in the assumed rate of increase in healthcare costs would have the following effects for the group:

	<i>Health Care Cost Inflation</i>		
	<i>Central Assumption 8.25%</i>	<i>-1%</i>	<i>+1%</i>
Accrued liability 31 March 2008 (R'Million)	261.987	221.745	313.283
% Change	-	-15.4%	+19,6%
Current service cost + interest cost 2008/09 (R'Million)	35.162	29.115	43.032
% Change	-	-17.2%	+22,4%
Sensitivity results from previous valuation	Central Assumption 6.75%	-1%	+1%
Current service cost + interest cost 2007/08 (R'Million)	28.090	23.430	35.357
% Change	-	-18.0%	+23,7%

23. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The group's financial instruments consist mainly of cash and cash equivalents, accounts receivable, certain investments and accounts payable, which arise directly from its operations.

The principle market risks to which the group is exposed through financial instruments are:

- Foreign exchange rate generating translation and transaction gain and losses
- interest rates
- credit risk
- liquidity risk

23.1 Foreign Currency Management

The group has transactional currency exposures which arises from sales or purchases in foreign financial currencies.

23.2 Interest Rate Management

The group's exposure to the risk of changes in market interest rates relates primarily to the group's short term loan and cash and cash equivalents. In the ordinary course of business, the group receives cash from the transfer payment to fund its operations as well as to fund working capital and capital expenditure requirements. This cash is managed to ensure surplus funds are invested in a manner to achieve maximum returns while minimising risk.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

23.3 Credit Risk Management

The group only deposits cash surpluses with major banks of high quality credit standing.

Trade account receivables comprise a widespread customer base. The granting of credit is controlled by well established criteria, which are reviewed and updated on an ongoing basis.

At year end, the group did not consider there to be any significant concentration of credit risk which has not been insured or adequately provided for. With respect to credit risk arising from the other financial assets of the group, the group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The maximum credit exposure is the carrying amount of financial assets as disclosed in the balance sheet.

23.4 Liquidity Risk

The group's objective is to maintain a balance between continuity of funding and flexibility through the use of call accounts. The group maintains a sufficient level of liquidity to be able to meet all its obligations. The company has no overdraft facility. No additional banking facilities or reserve borrowings are considered necessary.

23.5 Capital Management

The primary objective of the group's capital management is to ensure that it maintains healthy capital ratios in order to support its business. The group manages its capital structure and makes adjustments to it in light of changes in economic conditions.

The group does not have external imposed capital requirements. The group considers the following as its capital requirements and there were no changes from prior years.

CORPORATION			GROUP	
2007	2008		2008	2007
Rm	Rm		Rm	Rm
39.6	18.2	Trade and other payables	92.0	124.6
(291.2)	(317.4)	Cash and short term deposits	(312.5)	(288.0)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

23.6 Fair Values (Group)

	CARRYING AMOUNT		FAIR VALUE	
	2008	2007	2008	2007
	Rm	Rm	Rm	Rm
Financial assets				
Other assets	30.0	35.0	17.1	20.9
Accounts receivable	153.6	139.7	153.6	139.7
Cash allocated to insurance reserve	25.4	24.7	25.4	24.7
Cash and cash equivalents	287.1	263.3	287.1	263.3
Financial liability				
Accounts payable	(145.2)	(170.3)	(145.2)	(170.3)

The carrying amounts for cash, cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term nature of these instruments. The fair value of other assets was determined using the present value of future cash flows at an average discount rate of 13,8%. The amounts are payable within three years.

23.7 Interest rate risk (Sensitivity analysis)

The group's exposure to the risk in market interest rates relates primarily to interest received on call accounts and fixed deposits.

Interest rate risk table

The following table demonstrates the sensitivity to a change in interest rates with all other variables held constant.

	Increase/Decrease in basis points	Increase/Decrease in surplus for the year and equity
2008	± 50	± R1,5 million
2007	± 50	± R1,4 million

24. INCOME TAX

The Corporation and its subsidiaries are exempted from income tax in terms of legislation.

25. INFORMATION REQUIRED IN TERMS OF SECTION 55(2) OF THE PUBLIC FINANCE MANAGEMENT ACT

25.1 An amount of R40 134 (2007: R50 014) relating to unrecoverable debts was written off during the year.

25.2 Fruitless and wasteful expenditure of an immaterial amount of R66 (2007 : R26 709) was incurred as a result of penalties levied on late deliveries.

26. COMPARATIVE FIGURES

Comparative figures have been reclassified where necessary. This only relates to other assets which was reclassified from trade receivables to other assets. Refer to Note 10.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

		FEES	BASIC SALARY	OTHER BENEFITS	ALLOWANCES	RETIREMENT AND OTHER CONTRIBUTIONS	TOTAL
	Notes	R	R	(14) R	(15) R	(16) R	R
DIRECTORS'/ EXECUTIVE MEMBERS' EMOLUMENTS							
31 MARCH 2008							
Directors' Emoluments							
Executive Directors							
Hoffmann CJ	1	-	564,674	59,568	77,690	72,802	774,734
Thomo HS		-	1,217,136	108,624	187,680	215,296	1,728,736
Subtotal		-	1,781,810	168,192	265,370	288,098	2,503,470
Non-Executive Directors							
Gamede CV		166,645	-	-	-	-	166,645
Human AS		131,338	-	-	-	-	131,338
Meyer RP		90,544	-	-	-	-	90,544
Molefe PS	2	228,934	-	-	-	-	228,934
Ramaremissa GN		126,829	-	-	-	-	126,829
Riba P	3	161,841	-	-	-	-	161,841
Subtotal		906,131	-	-	-	-	906,131
TOTAL DIRECTORS' EMOLUMENTS		906,131	1,781,810	168,192	265,370	288,098	3,409,601
Management Board Emoluments							
Executive Members							
Borotho NRM		-	874,980	74,682	104,028	117,116	1,170,806
Goduka TT		-	565,995	53,883	133,932	134,923	888,733
Grobler JG	4	-	186,484	-	32,860	44,654	263,998
Magojo X	5	-	570,917	66,321	70,749	87,561	795,548
Magwaza CN	6	-	200,568	35,861	37,705	47,511	321,645
Matibe MM		-	599,394	48,406	117,180	129,749	894,729
Mkwanazi JS		-	920,292	78,021	87,456	171,347	1,257,116
Msomi TN		-	739,029	57,863	79,932	128,952	1,005,776
Potgieter IF (dr)	7	-	124,884	-	25,395	30,926	181,205
TOTAL		-	4,782,543	415,037	689,237	892,739	6,779,556

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

	Notes	FEES R	BASIC SALARY R	OTHER BENEFITS (14) R	ALLOWANCES (15) R	RETIREMENT AND OTHER CONTRIBUTIONS (16) R	TOTAL R
<i>Directors' Emoluments Armcor Business (Pty) Ltd</i>							
De Necker JAJ (dr)	8	-	580,345	74,742	98,117	130,387	883,591
Hurter E	9	-	642,243	56,958	96,780	140,301	936,282
TOTAL		-	1,222,588	131,700	194,897	270,688	1,819,873

	Notes	FEES R	BASIC SALARY R	OTHER BENEFITS (14) R	ALLOWANCES (15) R	RETIREMENT AND OTHER CONTRIBUTIONS (16) R	TOTAL R
DIRECTORS'/ EXECUTIVE MEMBERS' EMOLUMENTS 31 MARCH 2007							
<i>Directors' Emoluments Executive Director</i>							
Hoffmann CJ		-	751,962	137,281	116,670	140,824	1,146,737
Thomo HS		-	1,138,779	214,582	187,680	201,797	1,742,838
		-	1,890,741	351,863	304,350	342,621	2,889,575
<i>Non-Executive Directors</i>							
Gamede CV		124,001	-	-	-	-	124,001
Human AS		135,915	-	-	-	-	135,915
Meyer RP		103,231	-	-	-	-	103,231
Molefe PS		216,050	-	-	-	-	216,050
Molope CWN	10	94,729	-	-	-	-	94,729
Ramaremisa GN		107,191	-	-	-	-	107,191
Riba P		140,423	-	-	-	-	140,423
Subtotal		921,540	-	-	-	-	921,540
TOTAL DIRECTORS' EMOLUMENTS		921,540	1,890,741	351,863	304,350	342,621	3,811,115

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

	FEES	BASIC SALARY	OTHER BENEFITS	ALLOWANCES	RETIREMENT AND OTHER CONTRIBUTIONS	TOTAL
Notes	R	R	(14) R	(15) R	(16) R	R
Management Board						
Emoluments						
Executive Members						
Borotho NRM	-	861,096	154,817	104,028	112,387	1,232,328
Goduka TT	-	527,994	102,945	133,932	125,783	890,654
Magojo X	-	653,151	117,826	94,332	115,584	980,893
Matibe MM	11	239,238	45,461	58,590	60,861	404,150
Mkwanazi JS	-	737,859	124,518	87,456	145,368	1,095,201
Msomi TN	12	175,953	-	19,983	33,482	229,418
Smith GJ	13	338,534	114,439	19,919	54,677	527,569
TOTAL	-	3,533,825	660,006	518,240	648,142	5,360,213
Directors' Emoluments						
Armcor Business (Pty) Ltd						
De Necker JAJ (dr)	-	684,903	130,661	123,600	153,263	1,092,427
Hurter E	-	592,668	108,863	96,780	130,364	928,675
TOTAL	-	1,277,571	239,524	220,380	283,627	2,021,102

Notes applicable to note 27

- Retired on 30 September 2007. Contracted in for a further two months, ending 30 November 2007.
- Appointment for a three year period as Chairman of the Board of Directors expired on 30 September 2007. Re-appointed as Chairman of the Board of Directors.
- Monthly fees paid over to employer, Nedbank, as from February 2008. Only fees for ad-hoc committee meetings paid to Ms Riba personally.
- Appointed from 1 December 2007 as Management Board member (Acting General Manager Finance and Infrastructure).
- Resigned from Armcor with effect from 31 December 2007.
- Appointed on 1 November 2007 to Management Board (Acting General Manager Corporate Affairs).
- Appointed from 14 January 2008 as Management Board member (Acting General Manager Human Resources).
- Deceased on 16 January 2008.
- Acting as General Manager Armcor Business (Pty) Ltd from 5 November 2007.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

10 Resigned on 31 March 2007 from the Armscor Board of Directors. Fees for 2006/07 were paid over to the Financial Services Board.

11 Appointed on 1 October 2006 to Management Board. (Acting General Manager Quality and IT).

12 Appointed on 1 January 2007 to Management Board.

13 Retired on 31 August 2006.

14 Include bonus and performance related payments.

15 Include sums paid by way of expense allowances ie. motor and cellphone allowances.

16 Include contributions made to any pension fund; medical benefit fund; medical aid; unemployment insurance fund and funeral funds.

17 No emoluments are paid to Armscor Business ex-officio Directors: Mr HS Thomo and JG Grobler.

Share options

No share options exist and therefore no share option gains are included in the amount of emoluments received as directors of the company.

Directors' service contracts

Notice periods in respect of service contracts of executive directors do not exceed one year. Non-Executive directors are not bound by service contracts.

Pensions

Pensions paid or receivable by executive directors are paid or received under defined contributory pension schemes.

28. RELATED-PARTY DISCLOSURES

The Armaments Corporation of South Africa Limited ("ARMSCOR") is a statutory body, wholly owned by the State, established in terms of the Armaments Development and Production Act (Act No 57 of 1968), and continues, its existence through the Armaments Corporation of South Africa Limited Act (Act No 51 of 2003).

To execute its mandate, Armscor received a Government grant of R415,6 million (2007: R347,6 million) from the State through the Department of Defence (DOD).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

Investment in subsidiaries and loans from subsidiaries as detailed below are set out in notes 11 and 16 of the financial statements.

SUBSIDIARIES	2008	2007
	<i>Rm</i>	<i>Rm</i>
Arm Scor Business (Pty) Ltd (Loan from)	97.5	97.5
Arm Scor Business (Pty) Ltd (Loan to)	(105.1)	(108.9)
Erasmusrand Eiendomme (Pty) Ltd (Loan to)	136.0	135.9
Oospark (Pty) Ltd (Loan to)	1.1	1.1
Sportrand (Pty) Ltd (Loan to)	2.0	2.0
	R	R
Institute for Maritime Technology (Pty) Ltd (Loan from)	(4)	(4)
Overberg Toetsbaan (Pty) Ltd ((Loan from)	(5)	(5)

Unsecured non interest bearing loans with no fixed repayment conditions. The shareholder has subordinated it's right to claim repayment of it's loan until such time as the assets of the company, fairly valued, exceeds it's liabilities.

The following table provides the total amount of transactions, which have been entered into by the group with related parties for the relevant financial year.

	<i>Sales of goods and services to related parties</i>		<i>Purchases of goods from related parties</i>		<i>Amounts owed by related parties</i>		<i>Amounts owed to related parties</i>	
	2008	2007	2008	2007	2008	2007	2008	2007
	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Arm Scor Business	23.9	14.7	66.2	69.3	-	-	-	-
Erasmusrand Properties (Pty) Ltd	-	0.1	-	-	-	-	-	-
Department of Defence	5.6	5.2	-	-	11.7	1.5	0.5	-
Other related party transactions carried out by the group:								
State controlled entities								
Major national public entities (Schedule 2 and 3 public entities)	265.8	122.5	788.4	1,101.9	15.2	14.3	3.8	3.7
National government	32.9	21.1	1.0	0.2	11.5	0.3	1.6	-

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made at normal market prices. Outstanding balances at the year-end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided or received for any related-party receivables or payables. For the year ended 31 March 2008, the group has made provision for doubtful debts of R24,1 million (2007: R14,0 million) relating to amounts owed by related parties.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2008 (continued)

Included in the above figures are payments of R7,8 million (2007: R7,4 million) in respect of a service level agreement paid by Armscor Business to Armscor, an amount of R38,7 million (2007: R37,3 million) paid by Armscor to Armscor Business for subsidiary support and rent of R2,8 million (2007: R2,6 million) paid by Armscor Business to Armscor.

In accordance with Armscor's mandate, acquisition was undertaken on behalf of the Department of Defence. These transactions are set out in note 7 of the financial statements.

Armscor Business had the following business with the DOD, as stated below.

	<i>Sales of goods to related parties</i>		<i>Purchases of goods from related parties</i>		<i>Amounts owed by related parties</i>		<i>Amounts owed to related parties</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>	<i>Rm</i>
Special and General Defence Account	721.7	890.0	9.4	-	11.1	25.7	31.2	14.8
DMD (Stock Sales)	-	-	13.4	97.5	-	-	-	47.5

Directors

Directors' interests in related parties: No interests in related parties have been declared by Armscor Directors.

One of Armscor's Directors and one Armscor Management Board Member are ex-officio directors of the Armscor Business Board of Directors. One Armscor Management Board Member is also ex-officio director on the Boards of Erasmusrand Eiendomme (Pty) Limited, Sportrand (Pty) Limited and Oospark (Pty) Limited.

Key management personnel

Information on the remuneration of all key management personnel is disclosed in note 27.

LIST OF ABBREVIATIONS

ABET	Adult Basic Education and Training
ACG	Armcor Consultative Group
ADAC	Armcor Defence Asset Management Centre
AMSL	Airbus Military Sociedad Limitada
ARMSCOR	Armaments Corporation of South Africa Limited
AUV	Autonomous Underwater Vehicle
BBBEE	Broad Based Black Economic Empowerment
BEE	Black Economic Empowerment
CAE	Computer Aided Engineer
COTS	Commercially-off-the-shelf
CPIX	Consumer Price Index
CSIR	Council for Scientific and Industrial Research
CV	Chemical Warfare
DAPD	Departmental Acquisition and Procurement Division
DERI	Defence Evaluation and Research Institute
DefMatDiv	Defence Matériel Division
DI	Defence Institute
DIP	Defence Industrial Participation
DMD	Defence Matériel Disposal
DOD	Department of Defence
DPSS	Defence Peace, Safety and Security
DRC	Democratic Republic of the Congo
DRDB	Defence Research and Development Board
DRI	Defence related industry
DTI	Department of Trade and Industry
EDM	Engineering Development Models
EMC	Electromagnetic compatibility
ENSP	Executive National Security Programme
EW	Electronic warfare
FIATA	Freight Forwarders Associations
FTI	The Flight Test Instrumented
GBADS	Ground Based Air Defence System
GDA	General Defence Account
GFC	German Frigate Consortium
GSC	German Submarine Consortium
IATA	International Air Traffic Association
ICT	Information and Communication Technology
IDE	Integrated Development Environment

LIST OF ABBREVIATIONS *(continued)*

IFF	Identification of Friend or Foe
ILS	Integrated Logistic Support
IMT	Institute for Maritime Technology
IMTD	Integrated Maritime Technology Demonstrators
IT	Information Technology
IMPS	Intellectual Property Management Support Service
LMS	Learner Management System
LUH	Light Utility Helicopters
LWS	Local Warning Segment
MIR	Multi-Influence Range
MOD	Minister of Defence
MOTS	Military-off-the-shelf
NGICV-PS	New Generation Infantry Combat Vehicle Products System
NIA	National Intelligence Agency
NIP	National Industrial Participation
NPC	Non-Proliferation Council
NQF	National Qualifications Framework
OATS	Open area test site
OPCW	Organisation for the Prohibition of Chemical Weapons
PCR	Polymerase Chain Reaction
PDSC	Plenary Defence Staff Council
PFMA	Public Finance Management Act
PSS	Product Support Supplier
PSTAR	Portable Sonar target
QA	Quality Assurance
RDT&E	Research, development, test and evaluation
RFQ	Request for Quotation
ROTE	Release to Operational Test and Evaluation
SA	South African
SAAF	South African Air Force
SAAFF	South African Association of Freight Forwarders
SABS	South African Bureau of Standards
SADCO	Southern African Data Centre for Oceanography
SADRI	South African defence-related industry
SAN	South African Navy
SANDF	South African National Defence Force
SAQA	South African Qualifications Authority.
SAPS	South African Police Service
SARS	South African Revenue Service

LIST OF ABBREVIATIONS *(continued)*

SATS	Sea Acceptance Trials
SDA	Special Defence Account
SDP	Strategic Defence Package
SETA	Sector Education and Training Authority
SHE	Safety, Health and Environmental
SLA	Service Level Agreement
SME	System Management Enhancement
TDP	Talent Development Programme
TETA	Transport Education Training Authority
TNF	Thales Naval France
WHO	World Health Organization
WSDS	Weapon System Decision Support



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