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AN ANALYSIS OF THE ARMAMENTS CORPORATION OF SOUTH AFRICA'S (ARMSCOR) DRAFT 2019/20 ANNUAL REPORT

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DISCLAIMER

Section 5(1)(d) The Money Bills and Related Matters Act (2009) outlines the procedure for the introduction of the national budget. It states that:

1) The National Assembly, through its committees, must annually assess the performance of each national department, with reference to the following:

> (a) The medium term estimates of expenditure of each national department, its strategic goals and measurable objectives, as tabled in the National Assembly with the national budget;
> (b) prevailing strategic plans;
> (c) the expenditure reports or statements relating to a vote appropriating funds for such department published by the National Treasury in terms of section 32 of the Public Finance Management Act;
> *(d) the financial statements and annual report of such department;*
> (e) the reports of the Standing Committee on Public Accounts relating to a department; and
> (f) any other information requested by or presented to a House or Parliament.

Sections 5(4-6) of the Act provide that the BRRR must be tabled before the adoption of the MTBPS report but after the adoption of the Appropriation Bill. Further the Act makes provision for the tabling of additional BRRRs at the discretion of committees.

Given the above, and in the context of the extended deadline to departments and entities for the submission of annual reports, Parliament will make use of 2019/20 quarterly reports as well as **draft Annual Reports** to compile a preliminary assessment of departmental performance for 2019/20 before a BRRR will be finalised when Annual Reports are submitted before 16 November 2020.

Members may note that this analysis is based on the draft Annual Report from Armscor. As such, information is yet to be audited and finalised and may change upon the submission of the finalised Annual Report. Furthermore, the analysis will not refer to the input of the Auditor General since this audit opinion has not been finalised

1. INTRODUCTION

The Armaments Corporation of South Africa Ltd (Armscor) was established in terms of the Armaments Production and Development Act (No. 57 of 1968) to satisfy the requirements of the South African National Defence Force (SANDF) in respect of Defence Matériel. In 2019/20, Armscor continued to provide this support to the Department of Defence (DOD) as its primary client. It is, however, operating under increasing financial constraint, as is the broader defence industry, due to funding constraints in the defence environment. *Of particular concern is the decreased defence contracts flowing through the DOD's Strategic Defence Account (SDA) which will significantly reduce acquisition work for Armscor over the MTEF. This requires Armscor to diversify its income stream to generate additional income.*

Important aspects noted by the Chairperson of the Armscor Board in the 2018/19 Annual Report:

- A new permanent CEO, Advocate Mbada, was appointed in the financial year and commenced his full-time responsibilities on 1 February 2020.
- Financial well-being was negatively impacted by the prevailing fiscal constraints.
- Armscor initiated the process of positioning Armscor as the primary procurement agency for the South African Government's security cluster; sweating our own assets; sourcing contracts from foreign governments through government to government contracting and through Intellectual Property exploitation. The Chairperson noted that this process is taking longer than envisaged.
- The declining SDA will in the next financial year decrease Armscor's workload from the client (DOD) and affect its critical competences and expertise to maintain strategic and sovereign capabilities.
- Challenges experienced by Denel have had a negative ripple effect throughout the industry and a determination on the vitality of Project Hoefyster is still outstanding.

This document analyses Armscor's major operations, including Acquisitions, Defence Industrial Participation (DIP), Research and Development, and the Armscor Dockyard. It also provides an overview of the current human resources situation and an overview of concerning Key Performance Indicators (KPI). It concludes with an analysis of financial statements.

The envisioned depletion of the Special Defence Account, which is the primary financing tool for the acquisition of all defence matériel is all but realised. During these challenging times, Armscor has had to evolve its own responses to this unfolding reality. The defence industry as a whole, which has had to bear most of the brunt…
- Armscor Board Chairperson (2019)

A Review of the legislative framework for performance assessment:
The Constitution vests the National Assembly with the power of oversight over their respective executives, in addition to their legislative and other powers. Furthermore, the Money Bills Amendment Procedure and Related Matters Act, 2009 (Act 9 of 2009) stipulates the procedure to be followed by Parliament prior to the introduction of the national budget. Section 5(1) states that the National Assembly, through its committees, must annually assess the performance of each national department, with reference to the following:

- The medium term estimates of expenditure of each national department, its strategic priorities and measurable objectives (APP), as tabled in the National Assembly with the national budget (ENE);
- prevailing strategic plans;
- the expenditure report relating to such department published by the National Treasury in terms of section 32 of the Public Finance Management Act (quarterly expenditure);
- the financial statements and annual report of such department (Annual Report);
- the reports of the Committee on Public Accounts relating to a department; and
- any other information requested by or presented to a House or Parliament.

The outcome of the performance assessment process followed by Committees is to annually submit a **budgetary review and recommendation reports (BRRR)** for tabling in the National Assembly, as per Section 5(2) of the Money Bills Amendment Procedure and Related Matters Act. The BRRR -

- Must assess the department's service delivery performance given available resources;
- Must provide an assessment on the effectiveness and efficiency of the departments use and forward allocation of available resources; and
- May include recommendations on the forward use of resources.

The *PCDMV* should keep the above-mentioned outcomes of the BRRR in mind during its deliberations with Armscor on its Annual Report in order to deliver a substantial BRRR.

2. ACQUISITIONS[1]

Acquisitions for the SANDF and other government departments reflect Armscor's core function, but is coming under increased pressure due to limited capacity by the DOD to engage in capital acquisition. The acquisition responsibility of Armscor can be broadly classified into two main categories being, capital acquisition (funded by the SDA) and system support and procurement (funded by the General Defence Account). Capital acquisition entails projects that cater for technology development, directed systems development and the subsequent production of new defence matériel, while system support and procurement involves operating procurement, maintenance and support of existing equipment and systems.[2] In the 2019/20 financial year, Armscor managed and executed contracts worth R12.19 billion, including the following:

- Maintenance and support contracts worth R4.4 billion (compared to R4.32 billion in 2018/19).
- Capital acquisition contracts managed worth R7.7 billion (compared to R7.44 billion in 2018/19).

[1] Armscor. (2020) p. 49
[2] Armscor. (2019). p. 41

The SDA and decreasing Armscor opportunities

The draft Armscor Annual Report for 2019/20 notes the following which may be of value to the PCDMV to consider during deliberations on the BRRR:

The SDA (capital budget) has been decreasing significantly over the past two years. During the reporting period (2019/20) there were 39 funded projects under the SDA. This will decrease to 15 during the 2020/21 financial year, and in the 2021/22 financial year, there will be partial funding for only one project. This dramatic decrease in the number of funded projects on the SDA will have a significant impact on Armscor, not only with respect to workload but also on Armscor's ability to maintain critical capabilities and expertise in the strategic domain in the absence of any projects being executed in those domains. The reduction of the capital budget will also result in a substantial change in the ratio of contract values between capital and operating budget funded contracts, in favour of procurement and maintenance and support activities.

Armscor managed acquisition and maintenance programmes for several defence systems, of which the following should be noted (Members should note that the majority of these acquisition programmes are multi-year acquisitions and projects will span several years. The ongoing monitoring of these projects to ensure on-time delivery and value-for-money is essential):

Maritime systems. *A Hydrographic vessel* is being purchased for the SA Navy under Project Hotel. Construction was set to start in 2018 and this was achieved through a steel-cutting ceremony hosted on 30 November 2018. Durban-based Southern African Shipyards (SAS) is the main contractor for Project Hotel to supply the SA Navy with a new hydrographic vessel and ancillary equipment. [3] At the end of 2019/20, construction of the main vessel was 64% complete, and construction of the three small motor boats was 75% complete. Additional tests were required by Armscor, resulting in a five-month delay in the project.

Furthermore, an acquisition process for three new *Inshore Patrol Vessels* (IPVs) is in progress under Project Biro. Previous Annual Reports noted that, by December 2017, the contract was awarded for the construction of the three IPVs. The contract was awarded to Cape-Town Based Damen Shipyards.[4] A similar tender for three Offshore Patrol Vessels has been put on hold. The 2019/20 Annual Report notes that the IPV contract is progressing according to schedule and that the first vessel is set to launch by the end of 2020.[5]

Finally, as reported in previous years and observed during the PCDMV oversight visit to Simon's Town in 2019, midlife upgrades on both the SA Navy's frigates and submarines are delayed due to a lack of funds.

Potential BRRR discussion points:

- *The Committee may consider the importance of finalising Projects Biro and Hotel, given the potential penalties that will be imposed should the projects not be finalised*

[3] Armscor. (2019). p. 45
[4] Damen. (2018).
[5] Armscor. (2020). p. 52

- *as per contract. Furthermore, the vessels will provide the SA Navy with much needed patrol and other operational capabilities. To this extent, the Minister of Defence in consultation with the Minister of Finance should ensure that sufficient funds are available to finalise the projects.*
- *The Committee may consider requesting a full report of the repair and maintenance status of the SA Navy's frigates and submarines and what the long-term impact will be of the current lack of maintenance due to a lack of funding.*

Airborne systems. The Annual Report[6] notes that the A-Darter Air-to-Air missile was completed at the end of 2019. This marks a significant milestone and offers a unique domestic capability to the SA Air Force. However, the industrialisation and large-scale production of the A-Darter has been significantly delayed by difficulties in Denel. Delivery of the first batch of missiles and initial logistic support capability is expected by the middle of 2020, but the schedule remains at risk due to capacity, capability, supply chain and financial challenges being experienced by Denel. The integration of the missile system on the SA Air Force Hawk aircraft has subsequently been deferred as well.

Potential BRRR discussion points:

- *The Committee may consider the operational impact of the lack of industrialisation of the A-Darter project on SA Air Force capabilities.*

Landward acquisitions. The most significant acquisition in the landward defence environment is Project Hoefyster which relates to the purchasing of new Infantry Fighting Vehicles for the SA Army to replace the ageing Ratel fleet which has been in service since 1976. An order for 244 new vehicles was placed with various variants to be delivered to the SANDF. The majority of the new fleet will be constructed in South Africa and a locally designed and manufactured turret is used. While the first batch of 21 vehicles have been delivered from Finland, **local manufacturing by Denel has seen significant delays**.

- *2019 Progress*: The 2018/19 Armscor Annual Report[7] notes that the project was already 43 months behind schedule by the end of the 2018/19 financial year. Furthermore, "during December 2018, Denel formally notified Armscor and the DOD that it is unable to deliver against the current contract baseline in terms of technical specifications, delivery schedule and price as contracted. The way forward with the programme is being addressed within Armscor and the DOD, and possible alternative approaches with associated implications to mitigate the financial and capability risk to the DOD is being investigated."

- *2020 Progress:* The industrialisation of vehicle assembly at Denel Vehicle Systems has not shown any significant progress since the previous reporting period, mainly as a result of parts shortages due to non-payment of suppliers. The delivery of the first Battalion consisting of 88 vehicles was contractually scheduled to be completed by May 2019. This date was however not achieved due to delays in the development and industrialisation process, and the latest indicated delivery date for the first battalion is June 2022, however with a low measure of confidence.

[6] Armscor. (2020). p. 53
[7] Armscor. (2019). p. 47

In addition to Project Hoefyster, Phase 1 of a new Ground Based Air Defence System (GBADS) for the SA Army was delivered to the Air Defence Artillery Formation. This focused on refurbishing the radar-guided system 35mm guns of the Air Defence Artillery Formation. A second phase of the GBADS is currently under way and focuses on the upgrade of the 35mm anti-aircraft guns' Fire Control system. The project is, however, not fully funded. Despite not being fully funded, it is anticipated that the product baseline, which will conclude the development work of this phase will be achieved by March 2021.

Potential BRRR discussion points:

- On 28 May 2020, the JSCD received a briefing from Armscor and Denel on Project Hoefyster. During the meeting it became evident that problems in the project remain far from resolved and that multi-year delays are likely to continue. This raises the question as to the ongoing feasibility of Project Hoefyster. On the one had it was noted that the cancellation of the project would be catastrophic for the financial sustainability of Denel. There are also sunken costs that the DOD has invested into the project thus far that will be lost should it be cancelled. On the other hand, Armscor shows low confidence in the ability of Denel to deliver on the project. This suspicion is confirmed when considering that, in September 2020, Chad signed a new agreement with a Nigerian armaments firm for armoured vehicles following the inability of 40 vehicles by Denel Land systems for a contract signed in 2017. With time passing on Project Hoefyster, it also brings into question whether the technology and hardware developed for the project will not be outdated by the time of production?
- In September 2020, the Minister of Defence indicated in a response to a Parliamentary question that "Armscor presented several options going forward with the project to relevant DoD forums. These options were thoroughly considered by Armscor and the DoD and a preferred option for deferment was further developed and motivated. This was supported by the SA Army, and presented to the DoD governance forums DOD and eventually recommended to the Armaments Acquisition Council (AAC) chaired by the Minister of Defence and Military Veterans. The AAC is the final decision making authority on projects and will provide guidance regarding going forward with the project."
  The primary responsibility of the PCDMV is to oversee the DOD and Armscor. From a contracting perspective, the feasibility of Project Hoefyster should be questioned as well as the impact on SANDF operational capacity. Urgent decisions on the way forward are required from the Armaments Acquisition Council.

2. DEFENCE INDUSTRIAL PARTICIPATION[8]

Defence Industrial Participation (DIP) relates to the obligation of a foreign supplier to reciprocate defence related business in South Africa as a result of a Defence acquisition. The DIP Policy was revised in October 2015. In 2019/20, Armscor managed 17 such agreements, which is higher than the 15 managed in 2018/19. Only one of the current DIP agreements are not related to the military (related to a SAPS pistol acquisition project). The value of DIP credits being managed remained similar to the previous financial year and comes to a total of R23.065 million compared to R22.589 million in 2018/19. The breakdown of this is as follows:

- DIP agreements related to the Strategic Defence Packages (1): R15.111 billion
- DIP agreements related to ongoing defence projects (13): R7.7 million
- DIP agreements related to the SAPS (1): R184 million

In previous years it was noted that one DIP agreement related to the 1999 Strategic Defence Procurement remained under the management of Armscor. This refers to an agreement with MBDA (a European based missile developer and manufacturer). After multi-year extensions, the 2019/20 Annual Report indicates that the obligation was concluded by MBDA paying a settlement amount to Armscor in terms of the DIP agreement.

The DIP agreement for supply of inshore patrol vessels was concluded in February 2020, and one claim has already been processed in this financial year.

3. DEFENCE MATERIEL DISPOSAL[9]

Armscor also manages the disposal of defence equipment such as vehicles, vessels, ammunition and other equipment for the DOD. During 2018/19, Armscor concluded orders to the value of R8.5 million. However, no amount was indicated in the draft 2019/20 Annual Report.

Potential BRRR discussion points:

- The disposal of defence materiel is an important aspect as it represents a form of revenue generation for the DOD. This links strongly to the sweating of assets as a means to generate revenue. *The Committee should encourage Armscor and the DOD to optimally manage the disposal of defence materiel to the full benefit of the Department. More information on the disposal functions of Armscor will be required during the Armscor Annual Report briefing.*

[8] Armscor. (2020) p. 55.
[9] Armscor. (2020). p. 87

4. RESEARCH AND DEVELOPMENT[10]

The Annual Report indicates that Armscor managed to earn R494.7 million from research and development projects, which is in line with that of 2019/2018. Research work contracted from the DOD constituted R242.98 million, which is significantly lower than the R337.6 million contracted in 2018/19. Commercial contracts for 2019/20 were valued at R127.43 million, which is lower than R152.3 million achieved in the previous year. The DOD also received a grant from the DOD for R101 million. The main reasons for the provision of the grant is not contained in the draft Annual Report. The bulk of research and development services took place at Research and Development Facilities such as the *Gerotek and Alkantpan* test facilities as well as *Hazmat protective systems.*

Alkantpan[11] is a munitions test range in the Northern Cape Province and attracts a number of local and international clients. Several international and domestic clients perform tests at the facility. Major milestones reached in 2019/2020 included the finalisation of the upgrading of tracking radars at the facility, allowing projectile testing to be effectively tracked. Funds were also secured for a new airstrip at the facility that will allow unmanned aerial vehicles (UAV) to land at the facility for testing. Armscor further reports in the draft Annual Report that, similar to 2018/19, performance of Alkantpan was negatively affected by an incident at Rheinmettal Denel Munitions (RDM) in Cape Town in 2018 resulting in a deadlock between RDM and the National Conventional Arms Control (NCACC).

Potential BRRR discussion points:

- Alkantpan is an important strategic facility for the South African defence sector and is crucial to the ability of Armscor to generate external funds. It is unclear from the draft Annual Report why a deadlock exists between Rheinmettal Denel Munitions (RDM) and the National Conventional Arms Control (NCACC), but this aspect requires clarification to ensure that income is not lost for the facility. *The Committee should request a report from Armscor on the exact financial impact of the deadlock as well as a report from the NCACC on the details thereof and the way forward.*

Hazmat[12] produces respiratory equipment for military and commercial purposes. The demand for military respiratory products diminished and Hazmat successfully transformed the business from only supplying the DOD with Chemical and Biological Warfare filters to a range of commercial PPE products, which are sold to the safety industry. At the end of the review period, sales increased significantly due to an unfortunate outbreak of the Covid-19 pandemic. Hazmat's sales (R15.9 million) for the financial year exceeded budgeted sales by 16%. The ability of Hazmat to produce required products during a pandemic shows the value of sovereign manufacturing capabilities such as Hazmat.

Other defence science technology institutes that receive the bulk of their funding from the DOD include:[13]

[10] Armscor. (2020) p. 57
[11] Armscor (2020) p. 60
[12] Armscor (2020) p. 60
[13] Armscor (2019) p. 60-66

- *Gerotek:* Gerotek Test Facilities was established to meet South Africa's needs to test defence-related products and to maintain key facilities, equipment, capabilities and technologies for that purpose. However, Gerotek has attracted numerous international and other private sector clients in recent years, forming an important part of Armscor's ability to diversify its income streams.
- *Armour Development*: Conducting of defensive and reactive armour development. Funded by the Research and Development Board. During the reporting period, all significant milestones on armour protection that could be used for current and future armour systems for the DOD were achieved and completed.
- *Protechnik laboratories*: Focus on chemical and biological defence. Two key highlights are noted for 2019/20. Firstly, Protechnik successfully competed in an Organisation for the Prohibition of Chemical Weapons (OPCW) open tender process for the offering of the annual Analytical Chemistry Course (ACC) to African member States. Second, Protechnik played an important role in testing chemicals and other products for efficiency during the initial phases of the Covid-19 outbreak. Protechnik designed, tested and evaluated a hand sanitiser and surface disinfectant with strict adherence to guidelines from the World Health Organisation that was distributed to the DOD and Armscor and sold to other state departments.
- *Institute for Maritime Technology*: Provision of techno-military expertise to support naval decision-making. The IMT is involved in various programmes, including the successful development of an Underwater Signature Multi-Influence Range Measurement System. One of the major projects that the Institute is working on is the Ultrasonic Broken Rail Detector, which has significant commercial potential. In the 2018/19 Annual Report, Armscor indicated that a commercial product is to be available by mid-2019/20. The 2019/20 draft Annual Report states that the Ultrasonic Broken Rail Detector test pilot in India was successfully completed and acknowledged by Indian Rail. It is therefore unclear if any commercialisation of the product has been finalised.
- *Ergonomics technologies*: Focus on integrating ergonomics into the SANDF.
- *Defence decision support institute*: Provision of decision support to the DOD.
- *Flamengro*: Computer aided engineering centre of excellence.

Finally, Armscor has indicated to the PCDMV in the past the importance of exploiting Intellectual Property (IP) as a means of generating revenue. This excludes sovereign IP that can only be exploited after due consideration. To this extent, Armscor established the Intellectual Property Management Division. In 2019/20, only one IP exploitation request was received by the Armscor's Board of Directors. This request was processed and recommended by Armscor's Board of Directors.

Potential BRRR discussion points:

- The strategic facilities of Armscor noted above are crucial to not only to South African sovereign defence capabilities, but also to Armscor financial sustainability in times of diminishing DOD contracting. *The Committee should encourage Armscor to seek ways to amplify the commercialisation of these facilities in an effort for the strategic value that they offer to be maintained.*

5. THE ARMSCOR DOCKYARD[14]

The Armscor Dockyard serves as the primary maintenance supplier to the SA Navy. It has come under increasing strain in recent years due to financial concerns and this has impacted on the Dockyard's ability to provide all required services to the SA Navy. As such, a Renewal Strategy was developed to eliminate the institution's financial deficit and increase efficiency. The Renewal Strategy will be implemented over three years, with the first phase focusing on eliminating the financial deficit. The 2019/20 draft Annual Report notes that progress to date yielded the desired results and the implementation is ongoing.

> *The current budget is insufficient to maintain and repair the operational output of the SA Navy, which in turn is posing a major capability risk on the Armscor Dockyard as its primary repair authority.*
>
> *- Armscor Annual Report*

The Armscor Dockyard's performance is based on a service level agreement between the SA Navy and Armscor. This is reviewed annually, and signed off against the mutually agreed milestones at the end of the reporting period. In this regard, the Dockyard met all its obligations and performances. All projects were delivered within the mutually agreed milestones. The draft Annual Report further highlights the specific and ad hoc repair and maintenance conducted on specific SA Navy vessels. The Dockyard is also engaged in the process of re-establishing its internal combustion engine maintenance capability. This capability was in the Armscor Dockyard but deteriorated over time as most of the maintenance work on the Navy's diesel engines was outsourced.

Crucially, amid current financial constraints, Dockyard embarked on an initiative to generate income and augment the shortfall in funding received from the SA Navy through commercial activities. This is done by engaging local marine and manufacturing commerce to utilise idle capacity to generate income. This is currently being done through several ship repair agents that are bringing their commercial work to be done in the Armscor Dockyard.

Potential BRRR discussion points:

- The implementation of the Dockyard's Renewal Strategy is encouraging as it is noted that thus far it has showed positive results.
- The efforts by the Dockyard to re-establish its internal combustion engine maintenance capability is a positive development and will make the Sa Navy less reliant on foreign suppliers and also provide Armscor with additional capabilities and income streams. *The Committee should track progress in this regard.*
- *The efforts to commercialise some parts of Armscor work as a means of diversifying its income streams should be welcomed and Armscor should be encouraged to continue to expand this capability while prioritising SA Navy projects.*

[14] Armscor. (2020) p. 67.

6. HUMAN CAPITAL MANAGEMENT[15]

The 2018/19 Annual Report indicates that Armscor, including the Armscor Dockyard, has a staff complement of 1 556, which is higher than the staff complement of 1 467 in 2018/19. However, this figure requires clarification as the salaries bill of Armscor is lower in 2019/20 than in the preceding year.

Armscor developed an Employment Equity Plan, partially focused on increasing the number of black women and persons with disabilities in the entity. The plan was in place until March 2020. Currently, in terms of Employment Equity, 82.97% of the Armscor Human Resources contingent are black. This is a further increase from 2018/19 when the percentage stood 80.23%. The 2019/20 draft Annual Report further indicates that 38.43% of employees are female, which also represents an increase from the 36.95% in the preceding year.

Armscor should also be lauded for identifying capability retention and succession planning as key focus areas. In 2019/20, 90 key position were identified as well as 88 potential successors and a mentorship programme initiated. This translates to an 84% compliance with the development plan as contracted with successors.

A positive initiative from Armscor that has been in place for several years is that it continues to provide skills development through a number of programmes, the following of which are noteworthy:

- Bursaries. 37 Bursaries were made available to undergraduate students at various universities This is in line with the 35 bursaries awarded in the preceding year.
- Defence Engineering and Science University Programme. In 2019/20, 104 students were funded for the 2019 academic year.
- Graduate Development Programme. For 2019/20, 40 candidates participated in this programme.

Unlike previous years, the 2019/20 draft Annual Report does not indicate any international training opportunities presented by Armscor. For example, in 2018/19, two employees were registered for Masters in Science: Military Aerospace and Airworthiness, studying for an Advanced Masters in Unmanned Aircraft Systems Management programme.

Potential BRRR discussion points:

- The increase in the number of employees at Armscor from 1 467 in 2018/19 to 1 556 in 2019/20 ought to be clarified. If this reflects a true increase, it will place Armscor under increasing financial pressure amid decreasing DOD contracting. *The Committee may request a forward planning document from the Armscor on how the company will manage Human Resources and training opportunities going forward, especially amid decreasing DOD contracting and subsequent financial constraints.*

[15] Armscor. (2020). p. 93-96

7. PERFORMANCE OVERVIEW: UNDER ACHIEVEMENTS AND CHALLENGES[16]

Armscor performed relatively well when performance against set targets are measured. *A total of 34 Key Performance Indicators (goals) were set for 2019/20 in relation to its Service Level Agreement Requirements and Group Performance Targets. Armscor managed to achieve 28 of these, which is a success rate of 82.35%. This is an improved performance when compared to the 75% achievement of 2018/19.*

Prior to highlighting targets not achieved, it should be noted that previous years' Annual Reports had a target related to a percentage increase in commercial income from Research and Development facilities. This target was not included in the 2019/20 Report and is concerning given the apparent need for commercial income amid financial constraints.

Table 2: Selected Key Performance Indicators not achieved/partially achieved in 2019/20

Objective	KPI	Goal	Achievement	Comments
Procurement	Percentage of DOD system support and procurement requirements converted into orders placed including: • Receipt of requirement. • Assessment and confirmation of requirement. • Initiation of sourcing solution. • Approval and placement of order.	95%	92.45%	DOD requirements to the value of R824.18m were received. Armscor committed R761.99m of the above mentioned funds resulting in an achievement of 92,45%.
Revenue Generation	Revenue generated from the Business Enablement Business Unit.	R85.2 million	R31.8 million	
Infrastructure renewal	Implementation of the approved application system renewal plan.	80%	40%	Request for Bid was published on 12 March 2020, however only 40% of the approved application system renewal plan was implemented.

[16] Armscor. (2020) p. 35

Objective	KPI	Goal	Achievement	Comments
Infrastructure renewal	Development of SCM (e-procurement, and commercial/military off-the-shelf procurement), dependant on SCM solution.	31 March 2020	No opportunity to perform	This initiative is a remnant of the corporate objective (Armscor Corporate Plan 2018/19) that was to be completed on 30 March 2020. After implementation of the SCM Module that could not be achieved, as a result of the cancellation of an ERP contract, due to non-performance of the service provider. Board approval 18 March 2020.
Stakeholder management	Conduct integrated employee engagement survey and determine new baseline.	New baseline	No opportunity to perform	The survey could not be completed due to absence of employees as a result of Covid-19 National Lockdown Regulations
Transformation of corporation	improving female representation (overall).	40%	38.43%	

Potential BRRR discussion points:

- The Armscor Group performed relatively well against set targets. However, further scope for improvement remains.
- *The Committee may request Armscor to again include a target related to percentage increase in the commercial income from Research and Development facilities for 2020/21. Measures should also be put in place to improve revenue generated from the Business Enablement Business Unit.*

8. FINANCIAL STATEMENTS[17]

The draft 2019/20 Annual Report does not include Armscor's Annual Financial Report, but overarching corresponding figures were provided to the PCDMV by Armscor.

The total comprehensive income of the Group decreased from a surplus of R235.311 million in 2019/20 to a surplus of R178.658 million in 2019/20. Revenue generated increased from R1.754 billion in 2018/19 to R1.801 billion in 2019/20. However, this increase should be seen in context as it comprises an increased state allocation. The state allocation has increased significantly in recent years from R860 million in 2016/17, R1.047 billion in 2017/18, R1.105 billion in 2018/19 to R1.146 billion in 2019/20.

During the period under review, Armscor did manage to increase sale from goods and service which increased from R381 million in the previous year to R430 million in 2019/20. Income

[17] Armscor (2019) p. 129

from interest also increased significantly from R78.6 million to R106.7 million over the same period. Of concern, however, is the reduction in rental income from R143.6 million to R68 million.

The following additional financial matters should also be noted:

- Employee-related costs increased from R1.116 billion in 2018/19 to R1.127 billion in 2019/20.
- Salaries and wages decreased from R826.099 million in 2018/19 to R818.162 million in 2019/20.
- Under General Expenses, Armscor notes 'fines and penalties' of R690 000, while no such costs were incurred in the previous financial year.
- Compensation for executive directors decreased from R10.984 million in 2018/19 to R8.796 million in 2019/20. High spending during the preceding financial year could be ascribed to the need for an acting CEO during the latter part of the 2018/19 financial year.
- Compensation of non-executive Directors decreased from R6.209 million in 2018/19 to R6.168 million in 2019/20.

Finally, ongoing litigation against Armscor should also be considered:

- € 192 million against Armscor for services allegedly rendered by Plaintiff's (Beverly Securities Ltd and Beverly Securities Inc.) in establishing a clandestine Portuguese channel during the 1980's for transportation of 50 Oryx helicopters. The case is only awaiting expert witness submissions and a court date in Lisbon is expected in the near future.
- € 17.62 million and R258 168 against Armscor and Denel by Patria Land Systems (this relates to Project Hoefyster). The Plaintiff (Patria) claims that Denel and/or Armscor did not accept work delivered in accordance with an agreement entered into between Denel and the Plaintiff and furthermore demand payment of a number of invoices issued to Denel. The Plaintiff further claim that Armscor and Denel have entered into a *stipulatio alteri* for the benefit of Patria in terms of which Armscor would be liable for the invoices issued by Patria to Denel.

Potential BRRR discussion points:

- The Armscor Group remains highly dependent on a government transfer for financial stability. Whether this will come under increased pressure given current financial constraints remains to a concern.
- The outstanding litigation against Armscor is of concern. The Patria claim again shows the significant impact of Denel's lack of capacity on the project on the entities' financial positions.
- *The Committee should encourage Armscor to, where possible, decrease its dependence on the government transfer through exploring commercial opportunities. However, the Committee may also seek a commitment from the executive around its future commitment to Armscor and the need for maintaining some of the strategic capabilities.*
- *The Committee should seek clarity on all losses and further potential llitigation related to Project Hoefyster.*

REFERENCE

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