

# INTEGRATED REPORT

# TWENTY 19/20 INTEGRATED REPORT

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PART 1  
WhO We ARe

# Cont

## WhO We ARe

Vision, purpose and values 08

## Performance highlights 09

Chairperson's Report 12 Board of Directors 16  
Executive Committee and key senior personnel 20  
Divisional Chief Executive Officers 21 Organisational  
structure 22 Our global presence 23 Denel business  
model 24

## CReATING VAIUe FOR OUR STAKehOIDeRS

Human capital 27

Social capital 30

Environmental capital 32 Intellectual capital 34  
Financial capital 36

## STAKehOIDeR eNGAGeMeNT

Stakeholder engagement 39

Material issues 48

eXTeRNAI eNVIRONMeNT AND STRATeGY

External environment strategy 55

Strategy 56

DeNel SOC  
INTEGRATED REPORT 2019/2020

peRFORMANCe ReVleW

CEO's report 59

Operational reviews 62

Financial review 68

OUR GOVeRNANCe

How Denel is governed 75

CONSOIIDATeD ANNUAI FINANCIAI  
STATEMENTS

Directors' report 101

Report of the Audit Committee 107 Report of the Auditors  
General to Parliament 109 Annual financial statements  
124

## INFORMATION SeRVICe

GRI content index 243

Statistics 245

Glossary 254 Corporate information 256

This integrated report is available on Denel's website: [www.denel.co.za](http://www.denel.co.za)

DeNeI GROUp INTeGRATeD RepORT 2019/2020 5

PART 1 ARe  
WhO We



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W

security and related technology, to

## OUR VISION AND pURpOSe

### VISION PURPOSE

To provide turnkey solutions of defence,

We are an innovative global defence,  
security and related technology  
solutions company.  
our clients by designing, developing,  
integrating, testing and evaluating, and

supporting artillery, armour-protected vehicles,  
missiles munitions, unmanned aerial vehicle  
systems, aircraft maintenance and  
aerostructures based on high-end technology,  
effectively and effciently.

### OUR VAIUeS

## peRFORMANCe hIGHlIGHtS

Revenue: R2.7 bn Cash: R635 m 2018/19: R3.4 bn 2018/19:  
R606 bn

Debt: Equity -1.58:1 Borrowing R3.6 bn 2018/19: -1:36:1 2018/19:  
R3.7 bn

Net Profit/Loss R1 962 m R&D Spend R53 m 2018/19: R1 469 m  
2018/19: R108 m

B-BBEE: Level 4 ACI\* appointments: 90% 2018/19: Level 6  
2018/19: 83%

Female appointments: 43%  
2018/19: 58%

Black-owned spend\* R602 m Skills

development: R21 m  
2018/19: R417 m 2018/19: R32 m

Corporate social  
development: R- Employee



## PART 1 ARe WhO We

### WHO WE ARE

Denel is a state-owned commercially driven company and strategic partner for innovative defence, security, aerospace and related technology solutions.

Denel provides turnkey solutions of defence equipment to its clients by designing, developing, integrating and supporting artillery, munitions, missiles, aerostructures, aircraft maintenance, unmanned aerial vehicles systems and optical payloads based on high-end technology.

### OUR BUSINESS



### DENEL AERONAUTICS

Denel Aeronautics, an operating division of Denel and strategic capability for the South African National Defence Force (SANDF), delivers end-to-end-aeronautical solutions, including aircraft, engine and component maintenance, repair and overhaul (MRO), aircraft system upgrades and integration with a core manufacturing capability required for MRO support. Denel Aeronautics remains the Original Equipment Manufacturer (OEM) of the Rooivalk Combat Support Helicopter (CSH), as well the Design Authority of the Oryx Medium Transport Helicopter (MTH) and the Cheetah multi-role fighter aircraft. The Denel Technical Academy (DTA) continues to be incorporated under Denel Aeronautics.



### DENEL DYNAMICS

As an innovation leader in advanced systems technology, the core business of Denel Dynamics is the design, development and manufacture of tactical missiles and precision-guided weapons. It also offers competitive tactical Unmanned Aerial Vehicles Systems (UAVS) and high-speed target systems, and develops satellite systems for the South African government through the South African National Space Agency (SANSA). Denel Dynamics' flagship programmes include the A-Darter joint development of the air-to-air missile with Brazil and its successful relationship with the Finnish Navy using the Umkhonto surface-to-air missile. These programmes contribute to Denel's ability to penetrate international markets.



### DENEL IAND SYSTeMS



Denel Land Systems (DLS) is a leading project-based, consolidated systems designer and integrator of combat turrets, artillery and infantry systems, small arms and armoured vehicles. It is also a subsystem supplier for artillery, rapid-fire medium-calibre weapons and combat vehicle systems. Part of DLS, the Mechem business unit, is a global leader in solutions for a safer environment through the clearance of landmines and explosive remnants of war (ERW), as well as mine-and ballistic-protected vehicle design and manufacture. Its customers include the United Nations (UN), other international agencies, governments and commercial customers worldwide.



DENEL



Vehicle SYSTeMS



Denel Vehicle Systems (DVS) is a subsidiary of Denel SOC, which provides turnkey vehicle systems to military and police customers in South Africa and in selected export markets. DVS has three divisions, i.e. Denel Gear Ratio, Denel Gear Ratio and Denel Mechatronics. DVS has a long history of supplying the South African Army (SA Army), Armscor and other defence companies in the region. DVS also supplies customers, suppliers and other companies in the region.



## DENEL OVerBeRG TeST RANGE

Denel Overberg Test Range is a versatile test range for the evaluation of modern standard measurements for the local services ranges from tests to the evaluation of modern standard



test systems performance industries. Its spectrum of services ranges from air and air combat, to the

## DENEL pReTORIA MeTAI pReSSINGS

Pretoria Metal Pressings (PMP) is an integrated manufacturer of small- and medium-calibre ammunition, brass products, detonics, power cartridges and mining drill bits. The company has been supplying products to military and police forces, and to the hunting and sporting fraternities around the world, for more than 80 years.

## PART 1 WhO We ARe

*characterised by several challenges, some of which were carried over from the previous period. The Board has put a great deal of effort into turning the company around, improving corporate governance and establishing a stable management team.*

Our Shareholder, the Department of Defence, and the Board are confident that Denel remains a strategic asset for our country and will continue to do so. Denel remains confident that all its actions will yield positive results. Some of these actions include continuous engagements with our key customer, the Department of Defence, and the end-users the SANDF, which includes the South African Army, Air Force and Navy) regarding funding models to protect the company's strategic and sovereign capabilities, the regular monitoring of cash flows, and ongoing engagement with the Lenders group (Absa, Rand Merchant Bank and Nedbank), creditors, suppliers and National Treasury. There is a major emphasis on strengthening the balance sheet through efficient working capital management and improving the capital structure, as well as adherence to good governance in all its activities. As a result of these interventions, the Board believes that Denel will continue to operate as a going concern.

## ChAIRpeRSON'S REPORT

Some of the achievements for this period can be summarised as follows:

### TURNAROUND STRATEGY

Denel's turnaround strategy, which was necessitated by the liquidity challenges experienced over the past few years, is gaining momentum. My fellow Board members, together with the Shareholder, dedicated much of their time during the period under review engaging with various stakeholders to find solutions to a number of challenges that were identified in the previous financial year.

This strategy, developed in April 2018 when the new Board was appointed, remains at the core of Denel's mission to ensure the long-term sustainability of the organisation. Its key strategic



*I am privileged to have served as Chairperson of Denel during this period; albeit a period that was*

objectives include the following:

- Maximising the value of Denel's core business areas
- Delivering on strategic equity partnerships
- Exiting non-core business areas
- Improving corporate governance and combating fraud, corruption and wastage

- Driving cost reduction and optimising the utilisation of Denel's assets
- Securing funding through high-level support from the Shareholder
- Growing the company's order book
- Ensuring the retention of core skills and capabilities
- Restoring Denel's reputation and improving employee morale and loyalty

An important initiative that forms part of the turnaround strategy involved the exiting and winding up of loss making subsidiaries in order to reposition the company and restore its profitability. The first of these was the exiting of Denel's aerostructures manufacturing business,

which was expected to be largely concluded by the end of July 2020, resulting in an annualised savings benefit of R260 million.



As a wholly owned subsidiary of the state-owned company, Denel Aerostructures SOC Ltd specialises in aerospace design and the advanced manufacture of complex aerostructures. The winding up of Denel Aerostructures did not affect any other business conducted by Denel Aeronautics.

Another initiative that formed part of the turnaround strategy and presented an opportunity to stabilise the company on a more viable basis was the further exploration of strategic equity partners to enhance sustainable revenue and access to the markets. Denel received unsolicited offers from a number of parties during the period under review, all of which are exploratory at this stage.

The company will follow all the relevant legislative requirements in pursuing these preliminary interests in the next financial year. In the meantime, it is continuing with the disposal of all identified non-core assets and the winding up of its loss-making subsidiaries. It is also continuing to secure funds from debtors to enable the company to generate its own revenue and return to profitability

CORPORATE GOVERNANCE

The Board has continued to prioritise interventions to change the operating culture so that Denel can be viewed as a transparent and

honest partner to all its stakeholders. Following the departure of its Group CEO, Danie du Toit, Mr Talib Sadik, a non-executive director, was appointed as Interim Group Chief Executive in August 2020. We are confident that this will ensure a seamless transition while the Board appointment for a permanent Group CEO is underway.

The Board is furthermore committed to turning the tide on corruption and mismanagement at Denel. As such, it pursues strategic initiatives that are aimed at improving corporate governance and combating fraud, corruption and wastage, and restoring Denel's reputation.

The Board is encouraged by the Auditor-General's report on the supply chain improvements to prevent and detect irregular expenditure. In the meantime, investigations are underway to identify past transactions that may be condoned and in which disciplinary action may be taken.

Denel's forensic investigations related to the Chad contract, Denel Asia and VR Laser have been completed, reviewed by legal counsel and the recommendations are being implemented. Disciplinary hearings are ongoing, and statements related to these matters have been finalised and handed over to the SAPS for investigation into criminal matters.



RESPONSE TO THE COVID-19 PANDEMIC

Like many organisations across the country, Denel ended the financial year with the prospect of a nationwide lockdown. Government's response to the effects of the coronavirus (COVID-19) was anticipated to lead to major economic challenges, from which Denel would

not be immune. The defence and manufacturing sectors were expected to be severely affected by these economic challenges, which would also impact on several of Denel's activities, as well as its cash flow. However, the full impact of the pandemic will only be seen in the following financial year.

Denel nonetheless responded to the pandemic by coordinating a project aimed at the local design and development of medical ventilators to be used for the treatment of COVID-19 patients under Project Sabela. Engineers from Denel Dynamics and Denel Land Systems have been working in partnership with

Our Shareholder, the Department of Defence, and the Board are confident that Denel remains a strategic asset for our country and will continue to do so. Denel remains confident that all its actions will yield positive results.

DeNel GROUp INTeGRATeD RepORT 2019/2020 13

## PART 1 WhO We ARe

other state-owned entities, research organisations and specialist medical technology companies in the private sector to produce these ventilators.

Other divisions in the Denel Group also contributed to the national response to the pandemic. This included Denel Aeronautics, which provided valuable technical support to the helicopter fleet of the South African Air Force that was deployed in all the country's nine

provinces. The Oryx transport helicopters carried critical medical and humanitarian supplies to communities on a daily basis and conducted surveillance operations. Denel Aeronautics also carried out critical repair work on the main gearboxes of two Oryx helicopters and technical support teams were on standby around the clock to do maintenance, repairs and testing of equipment.

### AppRECIATION

On behalf of the Board, I wish to

acknowledge the work of the former Group CEO, Danie du Toit, who provided confidence in the company, both internally and externally, while leading the business turnaround plan. I also wish to acknowledge the support of Denel's management and its employees who have contributed to building our organisation and who remain committed to its future.

I wish to express my appreciation to our stakeholders, partners, suppliers and investor community for their continued support to Denel during the past year. Your backing and trust will enable Denel to grow its business in the years to come and add value to the South African economy and society.

As an organisation, Denel interacts with government departments and agencies on a regular basis, and I wish to thank key role players such as the Chief of the South African National Defence Force, General Solly Shoke, the former Secretary of Defence, Dr Sam Gulube, and Advocate Solomzi Mbada and his colleagues at Armscor.

Furthermore, I am appreciative of the support received from the Minister of Defence and Military Veterans, Nosiviwe Mapisa-Nqakula, who has been a tireless champion of the defence industry in general, and Denel in particular; the Minister of Public Enterprises, Pravin Gordhan, for the confidence he has displayed in the members of the Board; and Director-General Kgathatso Tlhakudi and the officials of the Department of Public Enterprises for their continued interest and support for Denel. I am also indebted to the Minister of Finance, Tito Mboweni, and his team at National Treasury, for their continued support, which will assist in returning Denel to a financially viable organisation.

While continuing our efforts to transform Denel into a sustainable defence and advanced manufacturing company, I wish to assure our employees, suppliers, customers and stakeholders that the Board's focus on financial sustainability is a top priority.

Monhla Hlahla







# BOARD OF DIRECTORS



**MS MONHLA HLAHLA (57)**  
*Bachelor of Arts Honours in Economics from Pomona College, Master of Arts in Urban and Regional Planning, Advanced Management Programme*

**INDEPENDENT  
NON-EXECUTIVE DIRECTOR  
& CHAIRPERSON**  
Appointed to the Board on 9 April 2018

**DENEL BOARD COMMITTEE**  
**MEMBERSHIPS:** Chairperson of the Board, member of the Personnel, Recruitment and Transformation Committee and member of the Social and Ethics Committee

**DIRECTORSHIPS:** Non-executive director at Ruta Thari Limited, Stanlib Limited and Asset Management, Exarro Resources Limited and Liberty

**Holdings**  
**MR TALIB SADIK (55)**  
*Bachelor of Commerce, Advanced Diploma in Accounting, Advanced Management Programme, CA(SA) He served as Group CEO of Denel between 2008 and 2012*

**INTERIM GROUP CHIEF  
EXECUTIVE OFFICER & EX  
OFFICIO DIRECTOR** Appointed to the Board on 9 April 2018

**DENEL BOARD COMMITTEE**  
**MEMBERSHIPS:** Invitee to the Board and Board committees

**DIRECTORSHIPS:** Non-executive director of Tohoku Properties, Sunspray Foods, Sectional Poles, Arpdeen Inv. and Sediba Trust

**MS CARMEN LE GRANGE (48)**

*BCom degree, Postgraduate Diploma in Accountancy, Theory in Audit Specialism, CA (SA)*

**GROUP CHIEF FINANCIAL  
OFFICER & EX OFFICIO  
DIRECTOR**  
Appointed as Group Chief Financial Officer with effect 9 September 2019

**DENEL BOARD COMMITTEE**  
**MEMBERSHIPS:** Ex-officio Director and invitee to the Board and Board Sub- committees

**DIRECTORSHIPS:** Power and Infrastructure Engineering (Pty) Ltd, Lincoln Advisory (Pty) Ltd, Abacus Insurance Limited, Abacus Life Limited, Independent Regulatory Board for Auditors (IRBA), Neledzi Woman Investments (Pty) Ltd





DR SIBUSISO SIBISI (65)

*PhD and BSc (Physics) in Science and Technology*

INDEPENDENT  
NON-EXECUTIVE DIRECTOR

Appointed to the Board on 9 April 2018

DENEL BOARD COMMITTEE

MEMBERSHIPS: Member of the Finance and Risk Committee and of the Audit Committee

DIRECTORSHIPS: Non-executive director at Liberty Holdings and Telkom SA SOC Limited

LIEUTENANT-GENERAL

(RETIRED) TEMBA  
TEMPLETON MATANZIMA (67)

*Presidential Strategic Leadership Development Programme, Master's Degree in Management and Development and Bachelor of Social Science*

INDEPENDENT  
NON-EXECUTIVE DIRECTOR

Appointed to the Board on 9 April 2018

DENEL BOARD COMMITTEE

MEMBERSHIPS: Member of the Social and Ethics Committee

DIRECTORSHIPS: Non-executive director of National Treasury (Management Performance Assessment Tool)

MS SUE RABKIN (72)

*BA Honours in English and Education*

INDEPENDENT  
NON-EXECUTIVE DIRECTOR

Appointed to the Board on 9 April 2018

DENEL BOARD COMMITTEE

MEMBERSHIPS: Member of Social and Ethics Committee and Risk Committee

DIRECTORS

BOARD OF



MRS GLORIA SEROBE (61)

BCom degree and MBA degree

INDEPENDENT

NON-EXECUTIVE DIRECTOR

Appointed to the board on 9 April 2018

DENEL BOARD COMMITTEE

MEMBERSHIPS: Chairperson of the

Finance and Investment Committee  
and member of the Audit Committee

DIRECTORSHIPS: Founder and  
Executive Director of WIPHOLD.  
Non-executive Director of Hans  
Merensky Holdings, and Adcorp  
Holdings

MR THAMSANQA MAGAZI (63)

Bachelor of Science in Business  
Administration, Master's in  
Business Administration (MBA)

INDEPENDENT

NON-EXECUTIVE DIRECTOR

Appointed to the Board on 9 April 2018

DENEL BOARD COMMITTEE

#### MEMBERSHIPS:

Chairperson of Personnel, Remuneration and Transformation Committee, member of Audit Committee and Risk Committee

**DIRECTORSHIPS:** A 100% shareholder and director of Reata Supplies International (company dormant) and non-executive director of Leshala Laruna Investments, Brighthorse Investments, Reatisa Smart Technologies, Avo Mac Enterprises

(Pty) Ltd and Reata Aviation Services (Pty) Ltd

#### MS NONZUKISO (ZUKIE) SIYOTULA (36)

*Bachelor of Accountancy (Honours), MBA, CA(SA)*

#### INDEPENDENT NON-EXECUTIVE DIRECTOR AND CHAIRPERSON

Appointed to the Board on 9 April 2018

**DENEL BOARD COMMITTEE MEMBERSHIPS:** Chairperson of the Audit and Risk Committee

and member of the Human Capital and Remuneration Committee

**DIRECTORSHIPS:** Executive Director of Siyotula Holdings (Pty) Ltd and non executive director at African Phoenix Investment Limited, Ogilvy and Mather South Africa (Pty) Ltd, Stangen Investments CC, Specpharm Holdings (Pty) Ltd, Specpharm Group (Pty) Ltd, Taste Holdings Limited, Toyota Financial Services (South Africa) (Pty) Ltd, Westcoal Mining, Lesco (Pty) Ltd



#### MR MANDLA MARTIN MNISI (40)

*LLB degree, LLM (Human Rights Law) and LLM (Banking and Stock Exchange Law)*

#### INDEPENDENT NON-EXECUTIVE DIRECTOR

Appointed to the Board on 9 April 2018

**DENEL BOARD COMMITTEE MEMBERSHIPS:** Member of the Risk

Committee and Finance and Investment Committee

**DIRECTORSHIPS:** Director - MNS Attorneys  
**GENERAL (RETIRED) SIPHIWE NYANDA (70)**

*Bachelor of Arts degree and Master of Science (Financial Management)*

**INDEPENDENT**

#### NON-EXECUTIVE DIRECTOR

Appointed to the Board on 24 May 2018

**DENEL BOARD COMMITTEE MEMBERSHIPS:** Member of Personnel, Remuneration and Transformation Committee and Finance and Investment Committee

**DIRECTORSHIPS:** Director of Gen S Nyanda Consulting and

Oasis Media

**MS KABELO LEHLOENYA (40)**

*Diploma in General Management,  
BCom (Accounting), BCom Hons  
(General), BCom Hons (Accounting),  
Postgraduate Diploma in Accounting*

*Sciences, CA(SA)*

**INDEPENDENT  
NON-EXECUTIVE DIRECTOR**

Appointed to the Board on  
24 May 2018

**DENEL BOARD COMMITTEE**

**MEMBERSHIPS:** Chairperson of the  
Risk Committee and member of the  
Audit Committee, and Finance and  
Investment Committee

*Engineering)*

**INDEPENDENT NON-EXECUTIVE**

**DIRECTOR** Appointed to the Board on 24  
May 2018

**DENEL BOARD COMMITTEE**

**MEMBERSHIPS:** Chairperson of the  
Social and Ethics Committee, member  
of the Risk Committee, and member of  
the Personnel, Remuneration and  
Transformation  
Committee

**DIRECTORSHIPS:** Managing  
Director of Tennelli Industries

**DR HANNELIE NEL (48)**



*Bachelor's  
degree in  
Engineering  
(Chemical  
Engineering),  
Master of  
Science  
degree in*

*Engineering and Doctorate in  
Engineering Management (Industrial*

DeNel GROUp INTeGRATeD RepORT 2019/2020 19

## PART 1 Who We ARe

## EXECUTIVE COMMITTEE



**MR TALIB SADIK (55)**

*BCom, Advanced Diploma in  
Accounting, Advanced Management  
Programme, CA(SA)*

**EXECUTIVE DIRECTOR**

Appointed to the Group  
Executive Committee in August  
2020

**DENEL BOARD COMMITTEE**

**MEMBERSHIPS:** Invitee to the Board  
and Board sub-committees

**DIRECTORSHIPS:** Non-executive  
director of Tohoku Properties,

Sunspray Foods, Sectional Poles,  
Arpdeen Inv. and Sediba Trust



**MS CARMEN LE GRANGE (48)**

*BCom degree, Postgraduate Diploma  
in Accountancy, Theory in Audit  
Specialism, CA (SA)*

**EXECUTIVE DIRECTOR**

Appointed as Group Chief  
Financial Officer with effect 9  
September 2019 **DENEL BOARD  
COMMITTEE**

**MEMBERSHIPS:** Ex-officio Director  
and invitee to the Board and  
sub-committees **DIRECTORSHIPS:**  
Power and  
Infrastructure Engineering (Pty) Ltd,  
Lincoln Advisory (Pty) Ltd, Abacus  
Insurance Limited, Abacus Life  
Limited, Independent Regulatory  
Board for Auditors (IRBA), Neledzi  
Woman Investments (Pty) Ltd

**MS MERCIA NGEMA (46)**

*MBA, Postgraduate  
Programme Organisational  
Development,  
Honours degree in HR Management*

**GROUP EXECUTIVE: HUMAN**

**RESOURCES AND**

**TRANSFORMATION** Appointed to  
the Group Executive Committee in  
July 2019

**MR KHOHLONG WILLIAM**

**HLAKOANE (48)**

*Mechanical Engineer with an MBA  
from the Milpark Business School*

**GROUP CHIEF OPERATIONS**

**OFFICER** Appointed to the Group  
Executive Committee in 1 July 2019

**DENEL BOARD COMMITTEE**

**MEMBERSHIPS:** Invitee to all  
Denel Board sub-committees

**DIRECTORSHIPS:** Appointed non  
executive director, and Chairperson of  
Strategy and Policy, Aerospace  
Maritime Defence Industries  
Association of South Africa

**DENEL BOARD COMMITTEE**

**MEMBERSHIPS:** Invitee to the  
Personnel, Remuneration and  
Transformation Board sub-committee





#### SELLO NTSHIHLELE (57)

*MEng (Electrical and Electronic), MBA*

#### CHIEF EXECUTIVE OFFICER: DENEL DYNAMICS

Appointed as Chief Executive Officer in 1 August 2019

**RELEVANT SKILLS, EXPERTISE AND EXPERIENCE:** Strategic development, strategic leadership, operations, programme management, product development of guided munitions, RAM engineering, system integration, business development, global partnering and negotiations

#### PHALADI PETJE (54)

*BA (Hons) Economics, BEd,*

*PDM (Business Admin), Diploma (Management), Executive Leadership Programmes*

#### CHIEF EXECUTIVE OFFICER: PRETORIA METAL PRESSINGS

Appointed as Chief Executive Officer in May 2013

**RELEVANT SKILLS, EXPERTISE AND EXPERIENCE:** Strategic planning, business development and business process re-engineering

#### MXOLISI MAKHATHINI (48)

*BSc (Electronic Engineering), National Diploma (Electrical*

*Engineering), MSAIEE*

#### CHIEF EXECUTIVE OFFICER: DENEL LAND SYSTEMS AND DENEL VEHICLE SYSTEMS

Appointed as Chief Executive Officer in September 2019

**RELEVANT SKILLS, EXPERTISE AND EXPERIENCE:** Vast executive leadership experience; Marketing and New Business Development; Extensive Programme Management Experience; Specialist Experience in the design of control systems; and broad exposure to advanced manufacturing processes (FMCG).



#### MICHAEL KGOBE (50)

*Master's degree: Aeronautical Production and Maintenance, Executive Leadership Programme, Executive Development Programme.*

**CHIEF EXECUTIVE OFFICER: DENEL AERONAUTICS** Appointed as Chief Executive Officer in March 2010

**RELEVANT SKILLS, EXPERTISE AND EXPERIENCE:** Leadership, strategic planning and implementation, policy formulation, professional practice and ethics, organising and planning, presentation and communication, research

and report writing, project planning and management, negotiation skills

#### BRIDGET SALO (43)

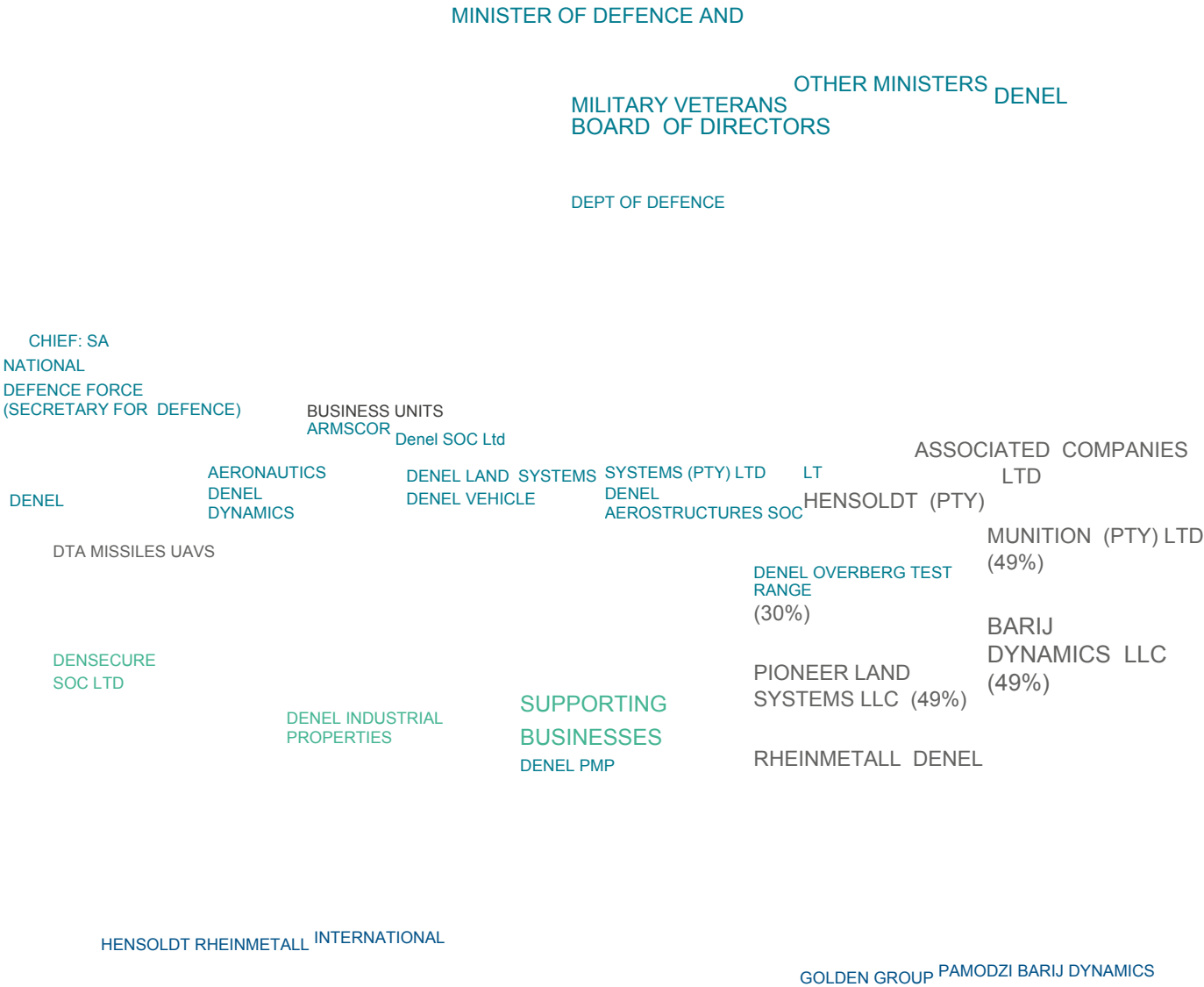
*Master's degree: Public Admin, BPA (Hons), BTech and NDip Public Management and Administration, Executive Leadership Programme*

**CHIEF EXECUTIVE OFFICER: DENEL OVERBERG TEST RANGE** Appointed as Chief Executive Officer in April 2020

**RELEVANT SKILLS, EXPERTISE AND EXPERIENCE:** Business and people management, as well as executive leadership experience

# STRUCTURE

## ORGANISATIONAL



Denel acquired the full stake in Turbomeca Africa, and it was incorporated into the Denel Aeronautics division. \*Denel Asia is in the process of deregistration.

## OUR GLOBAL PRESENCE

NORTH AMERICA ASIA  
PACIFIC  
AFRICA  
SOUTH AFRICA EUROPE  
MIDDLE EAST  
SOUTH AMERICA



# MODEL

## DENEL BUSINESS

### ACTIVITIES OUTPUTS OUTCOMES

#### CAPITAL INPUTS



- Internally developed systems R&D
- Unique customer solutions
- Skilled and technologically qualified employees

- Effective and responsible leadership
- Developing skills
- Transformed skills workforce
- Retaining key talent

- Profitability
- Order book quality and growth
- Source appropriate funding
- Access to funding
- Cashflow efficiency and working capital management

- Energy needs for manufacturing

- Effective engagements to:
- Employees and trade unions
  - Shareholders and funders
  - Customers and suppliers
  - Government and regulators

- Global demand for defence and security products
- Shareholder's Compact

#### EXTERNAL ENVIRONMENT



- Identifying customer needs

- Innovative technological advancements

- Scoping and contracting

- Developing cutting-edge technologies

demands

\*Further detail on products is found on pages 11 and 12 on Denel Capabilities

- Manufacturing, maintenance, assembly, integration and testing

- Delivery, product support and warranty

R&D spend  
R53 m

Sustained strategic capabilities

3 332 employees

Responsible leadership

R1354 bn  
paid remuneration

0 learnerships, sponsorships and other training

R2.7 bn  
revenue

R1 962 m  
loss

Cash and cash equivalents  
R635 m

Order pipeline <R26 bn

Skills development  
R21 m

Level 4

B-BBEE

CSI spend  
R-m

maintained  
relationship with organised labour



# CREATING



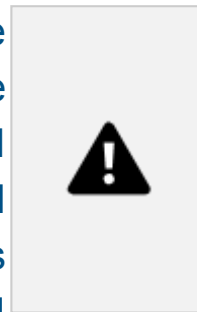
# VALUE FOR OUR STAKEHOLDERS

26 Denel GROUP INTEGRATED REPORT 2019/2020

PART 2

## HUMAN CAPITAL:

Denel is a proud South African public company that contributes greatly towards socio-economic development, youth development and employment creation. It is committed to building a sustainably profitable organisation with a diverse and capable workforce. The company's strategy on human capital management is aligned to its purpose statement and business turnaround strategy. The company offers distinct skills development opportunities and is proud of its committed workforce, which cuts across different occupational categories.



The human capital management and transformation function's purpose is to deliver sustainable fit-for-purpose business solutions to enable organisational effectiveness, productivity and efficiency improvement to enable the turnaround strategy.

As part of Denel's turnaround plan, the company

embarked on a process to exit non-core business, creating an opportunity to acquire strategic equity partners.

On the back of the Shareholder's Compact and the Denel Corporate Plan, human capital management and transformation actively focused on three strategic priorities for the period under review.

- Ensure business stability and productivity improvement – Maintain a stable labour environment, enhance employee engagement, maximise value for core business, and ensure sustainable cost optimisation.
- Organisation culture transformation – Cultivate a culture of high performance, improve employee morale, continuous improvement on governance, ethics and compliance including B-BBEE, restore Denel's brand and reputation.
- Leadership and technical capability development – Develop and retain leadership and technical capability, develop capacity to enable a talent pipeline and succession risk gap closure to secure the future of Denel.

## GOVERNANCE AND COMPLIANCE

Although Denel had received a non-compliance penalty and a fine from the Department of Labour for not submitting the 2018/19 Employment Equity Report. The outcome of the August 2019 Denel B-BBEE Audit also resulted in a Level 6 B-BBEE rating. The company had set a target to achieve a Level 5 B-BBEE rating for the period under review. Due to collaborated efforts and rigour demonstrated by leadership and employees, Denel achieved a Level 4 B-BBEE rating certificate for the period 2019/20. Key areas of improvement were in management control, employment equity, skills development (the absorption of learners) and an increase in localisation (procurement spent on defence material produced in South Africa).

This par excellence compliance achievement is a

clear demonstration of our employees' commitment, teamwork, cross-functional collaboration, and a consistent focus on culture transformation and organisation effectiveness.

## TALENT MANAGEMENT AND SKILLS DEVELOPMENT

The Group Talent management and Succession Management Framework has been developed to enable accelerated growth and development. The organisation successfully identified the "Top 20 Leadership" positions. A three-year gender responsive plan strategy has been developed as a result: the identification of the "Top 20" females in leadership for accelerated female development.

Leadership development and segmentation remains a critical factor going into the next financial year. In line with the culture transformation journey, Denel will be embarking on a process to redefine leadership competencies. Upon development of the leadership competencies, the organisation will embark on a process to identify, leadership development initiatives, targeting different segments of leadership and frontline management.

A climate survey was conducted to establish the relevance of the Denel values. The company embarked on a bottom-up approach, yielding to the development of transitional corporate values of performance, courage, accountability and integrity.

## PART 2 CReATING VAIUe FOR

## OUR STAKehOIdERS

The Denel Training Academy continues to be a hub for apprentice and artisan training, with the focus on skills that are relevant to Denel and the industry at large. Training takes one year of theory and includes preparation for trade tests. On-the-job

training is continuing well in the various divisions of Denel that have been accredited by the Manufacturing, Engineering and Related Services Sector Education and Training Authority (MerSETA) to provide on - the - job training. One of the critical elements considered this year was how to

streamline the intake, ensuring close collaboration and growth opportunity creation across different divisions.

Engineering academies in some Denel divisions are contributing to the group's development of a skills base by offering engineering graduates practical exposure to the primary engineering programmes in various divisions of Denel. This strategy continues to be a focus area going forward, more so as the organisation embraces the Fourth Industrial Revolution.

Although the organisation experiences liquidity challenges for the period in review, bursary graduates are continuously being absorbed into the



business after the completion of their studies. Graduates, mostly from technical disciplines, are given opportunities on short-term internship programmes by various Denel divisions. This process allows the graduates to acquire critical work skills, while simultaneously affording Denel divisions the opportunity to assess the graduates' employability. However, divisions are under no obligation to employ the graduates full time. This provides Denel with a bankable future skills pool/base to tap from as the company's financial situation improves in the coming years.

On a small scale, the Denel learnership programmes in the various fields enhance the company's employment equity profile. Skills gained in various divisions are varied and, in the coming years, learners that perform well during the learnership are to be integrated into the strategic workforce plan.

Denel proactively offers vacation work opportunities for students who are required to gain workplace experience to complete their tertiary qualifications. First opportunities are granted to Denel bursary holders, however, where an opportunity arises, non-Denel bursary holders are also accommodated.

Denel divisions have embarked in a skills verification audit process, with a key focus on programmes, in order to pro-actively manage possible risks that may hinder the delivery of key projects going forward.



The Denel divisions are robust in developing career paths to encourage younger employees to select the career progression routes that would contribute to the success of the group and best suit the individual. The career routes range from engineering-in-training through to principal

engineers, right up to consulting engineers. They also range from junior project/programme managers to specialist project /programme managers.

The Denel Mentorship programme is under review for further improvement. Solid mentorship provides the basis for these critical interventions. Each division has a mentorship programme in place that is constantly tracked and evaluated by the divisional training committees. Such programmes assist in the nurturing of future technical/ managerial abilities and the development of technical competence.

Denel acknowledges that currently there is a gap in the succession ratio, particularly in critical positions. An integrated Talent Management Framework and Philosophy has been developed to mitigate this risk over a specific timeline in order to secure the future of Denel. The company intends to strengthen the talent pool for all identified key positions within the group for succession management, leveraging on the rotation of people to maximise value.

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Total employees at 1 April 2019: 3 968	Although spending on training and remuneration may reduce the financial capital, the skills development of employees is important to provide skilled, motivated and productive employees	Amount paid in wages and salaries R1 380 m (2018/19: R2 145 m) Total headcount 3 332 (2018/19: 3 968) Artisans trained 212 (2018/19: 212) Spend on skills development R21 m (2018/19: R32 m)
Leadership structure		
Positive relationship with organised labour		
<b>Actions to enhance outcomes</b>		
<ul style="list-style-type: none"> <li>» Organisation stabilisation</li> <li>» Employee morale improvement</li> <li>» Critical skills retention</li> <li>» Accelerated skills development</li> <li>» Culture transformation</li> </ul>		

## PART 2

## CReATING VAIUe FOR OUR STAKehOIDeRS

## SOCIAL CApITAL

## EDUCATION INTERVENTIONS

The Denel group's social responsibility interventions are both a tangible expression of one of the company's values, which is "caring", and an important part of its commitment to the

Shareholder's Compact. The Corporate Social Investment (CSI) Programme is a key feature of how Denel conducts its business. As a state owned company, it has deliberately chosen to use CSI as a strategic lever to contribute, in partnership with government, to the elimination of the persisting social ills of poverty, unemployment and inequality.

The vision for the group's CSI is to build sustainable communities by leveraging off Denel's expertise in science, technology, engineering and mathematics (STEM) to support the country's human capital development strategy. Denel provides skills development to the youth, focusing on STEM education and training. Through these initiatives, it is intentionally and deliberately contributing to the development of the next generation of scientists, engineers, technicians and artisans.

Our corporate social responsibility (CSR) continues in line with our business obligation to serve the interests of our customers, employees, shareholders and the communities we work in. We have integrated our CSR work as an integral part of our core business processes and stakeholder management.

Despite the constraints caused by cash flow challenges within the business, we have managed to maintain some of our CSI activities during the past year, especially those associated with education and the youth.

Teacher Development / Salary Support: Denel pays the salary for extra teachers so that the school can accommodate more learners from the area. Learners from the area would have to commute extensively if they were not accommodated in these local schools.

The following programmes were suspended due to cash flow challenges:

Maths And Science Education

The Denel flagship intervention, which is the Schools

Outreach Programme (SOP), operated as an extra-tuition programme during weekends and school holidays. The SOP delivered additional tuition in Mathematics, Science, English and Life Science to learners in the beneficiary schools. The programme served as a feeder to Denel's skills development pipeline and learners who performed well in their matric year became eligible for a bursary to study at either a university or at the Denel Technical Academy.

In partnerships with the departments of Education in five provinces – Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga and the North West – the SOP had an annual average enrolment of about 500 learners in Grades 10 to 12. The additional tuition they received in the subjects contributed an extra 65 days to the academic calendar. The programme made immense contributions towards improving matric results over the

years. Denel partnered with the South African Air Force (SAAF) to host winter camps where learners were provided tuition in Maths and Science with an exposure to products and talent within the STEM environment.

Career expositions

Base Days: Working in close collaboration with the Department of Defence and Military Veterans, the Denel group implemented a programme of high-impact career expos that were hosted at military bases, particularly targeting the rural areas. The events provided information and an experience of Denel's products to rural learners, exposing them to possible career opportunities within the STEM field. The key elements were information sharing supported with a "see, touch and feel" experience on products designed and manufactured by Denel.

Government Outreach Programmes

In support of government's strategy for the cooperative implementation of programmes, Denel partners with the Department of Public Enterprises, as well as the Department of Higher Education and Training (DHET)'s strategic, high profile career days, which lead to broader brand exposure and profiling.



SUPPLY CHAIN INTERVENTIONS

Part of Denel's triple mandate, which informs the supply chain strategy and associated activities, is to be a commercially sustainable state-owned company and to contribute to the socio-economic objectives encapsulated in the National Development Plan. It is in response to this mandate that the supply chain division seeks to procure goods and services at the lowest total cost, while simultaneously advancing transformation objectives through targeted spend on eligible black-owned companies.

In order to achieve targeted spend, Denel is to actively invest in the development of black-owned companies with potential, as well as increased support for locally produced goods and services.

Local spend reduced from R1.8 bn (2018/19) to R1.6 bn (9.33% decrease) for 2019/20. The reduction in spend is mainly attributed to reduced operations and the continued liquidity challenges. The current financial year has seen a substantial increase in spend allocated to black/ designated groups, improving from R0.8 bn 2018/19 to R1.2 bn (45.78% increase). There has, however, been a significant reduction in spend on the black-owned youth and black people living with disabilities categories with R7.96 m (39.8%) and R9.46 m (20.04%), respectively. The Enterprise and Supplier Development Programme produced 58 beneficiaries, of which 40 (68.97%) are core and 18 (31.03%) are non-core.



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<p>Enterprise supplier development.</p> <p>CSI programmes that support Maths and Science learners.</p> <p>Collaboration with the Shareholder and funders.</p>	<p>The developmental spend on both the enterprise development and skills development must be balanced against the financial capital.</p> <p>The investment in communities through social investment will reduce the financial capital in the short term, but will result in growth in this capital in the longer term.</p>	<ul style="list-style-type: none"> <li>• Supply chain management system that is focused on the national plan to improve inequalities among previously disadvantaged individuals.</li> <li>• B-BBEE Status Level 4 (2018/19: Level 6)</li> <li>• Enterprise development spend: R3.6 m (2018/19: R3.8 m)</li> <li>• Learners who have benefited from the Schools Outreach Programme: 0 (2018/19: 430)</li> <li>• Total CSI spend: R0 k (2018/19: R539 K)</li> <li>• Contributes to the improvement of Maths and Science knowledge</li> </ul>
<p><b>Actions to enhance outcomes</b></p>		
<p>» Realistic and performance-based strategies to be implemented to improve not only spend in the black people living with disabilities and black youth-owned categories, but also revisit spend on Military Veterans. This will require a thorough market review for Denel's product and services portfolios and a robust supply chain strategy.</p> <p>» Improve the B-BBEE status levels</p>		

## PART 2

### CReATING VAIUe FOR OUR STAKeHOIDeRS

The group addresses environmental responsibilities in the design, manufacture, packaging and transportation processes of the value chain as part of an integrated environmental management system. Environmental impact

## eNVIRONMeNTAI CApITAL

The group's business delivers a positive impact on the country's economic and social development. However, industrial activities in areas where Denel operates might have inherent negative effects on the environment. It then becomes a strategic imperative to conduct business in an environmentally responsible manner to mitigate negative impacts to the environment.

### ENERGY AND CARBON EMISSIONS

Denel's ongoing commitment to reduce energy consumption and its carbon footprint is reflected in its

### MANAGING MATERIAL ENVIRONMENTAL IMPACTS



continuous investment in mitigation strategies. This is further apparent in the policy-driven objective to improve energy efficiency and reduce our direct greenhouse gas emissions.

Denel is constantly assessing its operational energy requirements and developing specific objectives and measures to be implemented. Denel has implemented an energy management policy that supplements the environmental management programme to address energy efficiency and reduce consumption.

studies and environmental risk assessments are included Denel's manufacturing plants require stable and as key operational and strategic imperatives in the affordable energy in an uninterrupted manner to business units' processes. Several environmental aspects operate efficiently. Across the group, the company have been identified as material for the Denel group and continues to implement energy conservation projects we manage, monitor and report on these on a regular to reduce energy consumption and carbon emissions. basis.

Social and Ethics  
committee  
Divisional CEOs

Protection of species and habitats, and the conservation of biodiversity and natural resources.

32 DeNel GROUp INTeGRATeD RepORT 2019/2020

WATER

The group recognises that water is a finite resource to be conserved as part of environmental sustainability. Measures are taken to ensure the efficient use of this finite resource, while maintaining operations and facilities at optimal capacity. Taking this to its ultimate conclusion requires investigating alternative sources of water such as groundwater (borehole water), which involves proper planning and related capital expenditure at an appropriate time. Water utilisation is quantified, reported and monitored across the group.

WASTE AND RECYCLING

The management of waste is an important element of environmental responsibility and is embedded in the environmental management systems of the group. Accordingly, waste management plans are developed, implemented and continuously reviewed

Denel screens suppliers using environmental criteria at most of its business entities and will extend these screenings to all campuses. The company is not aware of any potential or actual negative environmental impacts that could arise from its supply chain environment.

ENERGY EFFICIENCY PROGRAMME

Measures taken to maintain energy savings include instilling responsible energy consumption behaviour in the workplace. Building on the significant advancements in the energy efficiency improvement programme over recent years, we implemented a three-tier plan, which is reviewed and updated annually.

at local level, and both hazardous and non-hazardous waste are handled accordingly. Waste disposed of is reported and monitored in terms of the recycling, reuse and recovery waste management strategies.

PART 2

LAND STEWARDSHIP AND NATURE CONSERVATION

Denel's operations involve explosive and chemical-related activities, which increase the risk of contamination and pollution of the environment. Denel has put in place systems to detect and mitigate the adverse effects on the environment of its operations. The system includes procedures to handle or prevent major spillages that may contaminate land. These procedures are part of the emergency response plans in the safety, health and environment management system. During the year under review no material incidents were recorded.



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Electricity	Impacting negatively by using non-renewable waste and through emissions. We minimise impact through different initiatives indicated above.	Reduced energy consumption 68 380 160 kWh (2019/18: 78 159 000 kWh)
Water		
Waste		

#### Actions to enhance outcomes

- » Continuing to monitor and achieve energy-efficiency improvements
- » Sustainable water conservation programmes
- » Improving on-site waste disposal practice

## PART 2 CReATING VAIUe FOR OUR STAKeHOIDeRS

### INTeLleCTUAl CApITAl

Denel is continuously keeping abreast of new technologies, and maintaining the internal knowledge accumulated over many years, and across many different products. Investment in research and development (R&D) and the careful capturing and management of intellectual property (IP) during product development are critical to maintain and expand the technologies and capabilities required to offer world-class, high-technology defence products. This is in line with Denel's mandate as a key strategic organ of the state.

The tangible IP that Denel holds, together with the tacit knowledge of experienced and technically qualified employees, supported by the required specialist equipment and infrastructure, are key inputs in the intellectual capital, and define the capability of the

organisation.

Partnerships with academic institutions, research bodies and industry peers to develop, pilot and implement new technologies remain key in advancing new technologies. Collaboration with clients on new technology development or exploiting the rights to existing IP to fund new original work are platforms used to expand Denel's capabilities and to get access to new technologies that address specific or broad client needs.



The core capability of the business is supported by key organisational intangible assets, including, among others, the corporate know-how, management systems and company culture. Intangible intellectual capital is particularly relevant in the implementation of large-scale projects. In this respect, project management, specialist procurement, the management accounting, legal and contracting skills and efficient recruitment of the right human capital come to mind.

Denel is one of the few organisations in the country where engineers are exposed to the development of technically complex and large-scale systems engineering. Its products require elements of all engineering disciplines, as well as the best practices in applying the most recent technologies. This is a natural attraction for young engineers that are recruited from university and immediately adopted into functional teams within the business. This allows them the opportunity to be trained on-the-job while working individually and under the leadership and mentorship of experienced senior personnel. Postgraduate studies are encouraged, and continued training is well organised in the company. This ensures that Denel's workforce stays ready to face the requirements of this demanding and satisfying workplace.

During the project development phase, a challenge may

be that the complexity, or scope of work is sometimes underestimated during conceptualisation. This may lead to delays in project deliveries due to many unknowns and the complexity of the project as designs are mainly custom made to client needs. Denel has developed and adopted a project life cycle management framework that provides structure and guidance to predetermined “gate reviews”

associated with the various project life cycles. The framework provides a consistent performance monitoring and control system that integrates all the key activities throughout the whole life cycle of the project, from the bidding phase to the execution phase. The framework is currently being reviewed to include other aspects of project management, supply chain, contract management and cost management.

<p>Collaboration with client on new technology development</p> <p>Partnership with academic institutions</p> <p>Business processes and management systems</p> <p>Skilled and qualified employees</p>	<p>Investment in intellectual capital reduces financial capital in the short term, but increases financial and human capital in the long term.</p>	<p>Investment in R&amp;D R53 m (2018/19: R108 m)</p> <p>Investment in bursary and internship programmes</p>
<p><b>Actions to enhance outcomes</b></p>		
<p>» Investment in R&amp;D to keep abreast of the latest technology trends.</p> <p>» Providing training and skills development for artisans and engineers</p>		



## PART 2 CReATING VAIUe FOR OUR STAKehOIDeRS

### FINANCIAL CApITAI

Denel's strategic relevance for value creation for the Shareholder is to stimulate and support South Africa's economic growth. This is enabled by sustainable and bankable profits. Apart from creating value through business activities, Denel's mandate is also to reinvest the financial

capital created in each of the other

in a manner that is most  
and sustainable for the  
S.



The inputs to the financial capital are underpinned by access to adequate borrowings and maintaining adequate cash reserves. Denel aims to retain and improve financial strength. To achieve the strategic objective, the focus areas in 2019/20 were:

- Maintain access to capital borrowings
- Optimise cash conservation, unlock prepayments and renew National Treasury bank guarantees
- Structurally review the fixed cost structure throughout the group
- Optimise scarce resources to improve cost management

- Exercise resilience in working capital management
- Improve credit ratings
- Adopt an aggressive and focused cardinal campaign to increase the order book.

Long- and short- term borrowings Cash and cash equivalents Share capital and reserves	The financial capital allows the growth and sustainability of the business and has a positive impact on all the other capitals.	Earnings before interest and taxation – -R1 515 m (2018/19: -R1 339 m) Cash generated from operations – -R811 m (2018/19: -R217 m) Cash and cash equivalents – R635 m (2018/19: R606 m)
<b>Actions to enhance outcomes</b>		
<ul style="list-style-type: none"> <li>» Gain investor confidence to retain credit facilities</li> <li>» Improve working capital management processes to retain and generate cash</li> <li>» Review the cost structure to improve shareholder value</li> </ul>		



# ENGAGEMENT



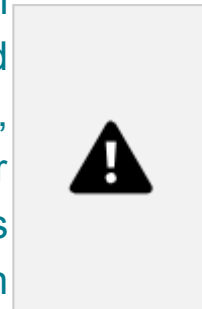
## STAKehOIdER

38 DeNel GROUp INTeGRATeD RepORT 2019/2020

PART 3

### STAKehOIdER eNGAGeMeNT

The King IV Report for Integrated Reporting identifies stakeholder engagement as an important part of integrated reporting. It is further seen as central to strategic business and reporting decisions. Over the period under review, Denel has continued to place stakeholder engagement and management at the centre of its business and delivery model. This has been particularly important as the business implements its turnaround strategy with efforts to rebuild confidence among its clients and stakeholders.



It is important that whatever changes the business is going through are communicated and appreciated by our stakeholders and that the brand repositioning gains foothold among our key stakeholders and the market in general. During the past year, we have benefited from the support of our Shareholder, government and parliament in navigating policy implications for the turnaround strategy. Government has also been at the forefront of assisting Denel to overcome its cash flow

challenges through support and guiding direction towards the long-term financial sustainability for the business.

We have continued to maintain the shareholder support, including marketing support and the resultant industry participation programmes.

Given the economic challenges facing the country and the resultant downturn in the defence industry, it had been important for the South African defence industry (SADI) to foster better collaborative efforts

in the delivery of orders. This has meant that both government and industry had to find ways to work together to ensure the sustainability of our country's defence capability, despite the difficult economic conditions we face. Engagements with industry, including those within the Denelcor supply chain, have been a critical component of such collaborative efforts. Denelcor continues to play an important role within the South African Aerospace Maritime and Defence Industries Association (AMD) and has maintained its seat on the board of the industry association.

PART 3

STAKEHOLDER ENGAGEMENT


SHAREHOLDER GROUP

The table below is an overview of the engagement process in the 2019/20 financial period.

SHAREHOLDER AND PARLIAMENT

STAKEHOLDER ENGAGEMENT REPORT APRIL

- Ministry of Public Enterprises
  - Director-General (DG)
  - Deputy Director-General (DDG)
  - Department of Public Enterprises
- Senior Management
  - The Presidency of the Republic
  - Parliament of RSA

ISSUES		ENGAGEMENT METHODS	OUTCOMES



<ul style="list-style-type: none"> <li>• Conclusion of cardinal campaigns • Exit of non-core assets, improve programme management, drive efficiencies and grow revenues</li> <li>• Maintain the shareholder support for Denel's business strategy, including marketing support, navigating the regulatory environment and industry participation programmes</li> <li>• Securing strategic equity partners</li> <li>• Repositioning capability systems</li> <li>• Driving operational efficiency improvements, penetrating export markets • Restructuring the Executive Committee (EXCO), senior management and managing overcapacity. Appointment of executive members at group level.</li> <li>• Denel recapitalisation</li> <li>• Denel's finances</li> <li>• Deregistration of Denel Asia</li> <li>• Aligning to the Shareholder's developmental agenda for Denel as articulated in the Shareholder's Compact • Update on the findings of Denel's forensic Investigations</li> <li>• Update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission</li> <li>• Government oversight of progress in advancing B-BBEE, diversity management and skills and enterprise development within Denel <ul style="list-style-type: none"> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Scheduled and ongoing engagements between the Minister and the Board Chairperson, Members of the Board and Executive Directors</li> <li>• Engagements to report on progress and strategic review of Denel's Shareholder's Compact targets with Department of Public Enterprises (DPE)</li> <li>• Bilateral and issue-specific meetings between the DPE and Denel's executive management</li> <li>• Oversight visit by the new members of the Portfolio Committee on Public Enterprises</li> <li>• Participations and visibility of the Shareholder in Denel's initiated stakeholder activities</li> </ul>	<ul style="list-style-type: none"> <li>• Application for recapitalisation through DPE and National Treasury has been made <ul style="list-style-type: none"> <li>• Progress has been made on expediting the strategy and implementation of the turnaround plan</li> </ul> </li> <li>• The Board and management is working tirelessly to restore and strengthen its relationship with the shareholder <ul style="list-style-type: none"> <li>• Better understanding of Denel's financial status and assistance to ensure financial sustainability</li> </ul> </li> <li>• Ensuring that credibility and reputation are restored through corporate governance, accountability and transparency • Support and alignment between the Shareholder and Denel to benefit the business</li> </ul>
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## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 — MARCH 2020

### SHAREHOLDER GROUP



#### PRIMARY CLIENTS AND CUSTOMERS

- Minister of Defence
- Department of Defence (DoD), Defence Secretariat and the SANDF
- Armscor

ISSUES	ENGAGEMENT METHOD	OUTCOMES
<ul style="list-style-type: none"> <li>Non-payment of customers and clients • Denel's recapitalisation <ul style="list-style-type: none"> <li>Hoefyster reset, restarting operations, support to ensure serviceability and availability of SANDF's main equipment</li> </ul> </li> <li>On-time delivery of products and improve programme management, delays on the Airbus A400M programme</li> <li>Road-shows to the DoD/ Armscor to report on the turnaround strategy milestones <ul style="list-style-type: none"> <li>Update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission • Deregistration of Denel Asia</li> </ul> </li> <li>Building and strengthening relationships with government, both as a partner in the development of the country, the Shareholder and as a key client</li> <li>Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>Monthly and weekly issue-driven meetings <ul style="list-style-type: none"> <li>Joint planning sessions between Denel and DoD/Armscor</li> </ul> </li> <li>Regular briefings to the Ministry, Secretary for Defence, Chief of the Defence Force, the Council on Defence (D), and the Plenary Defence Staff Council</li> <li>Monthly and weekly issue specific meetings, e.g. SAAF Denel Steering committee meetings <ul style="list-style-type: none"> <li>Submission of project reports • Joint planning sessions between Denel and DoD/Armscor</li> </ul> </li> <li>Ongoing and one-on-one meetings between Denel and Armscor's Board and EXCOS <ul style="list-style-type: none"> <li>Participation in relevant business events, strategic committees, working groups, forums and shows, IDEX 2019, LAAD 2019</li> </ul> </li> <li>Attending the DoD Budget Vote • Written comments and workshops between the DoD/ Armscor and Denel</li> </ul>	<ul style="list-style-type: none"> <li>Strengthened relationship and trust between Denel and the DoD <ul style="list-style-type: none"> <li>Strengthened relationship of mutual trust and support</li> </ul> </li> <li>Success on key campaigns and increase in orders placed with Denel <ul style="list-style-type: none"> <li>Armscor support of the defence industrial participation credits</li> </ul> </li> </ul>

## SHAREHOLDER GROUP

## OTHER GOVERNMENT DEPARTMENTS

## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 – MARCH 2020

- National Treasury
- Department of Transport
- South African Police Service
- Department of Science and Innovation •
- Department of Trade and Industry
- Department of

- Telecommunications and Postal Services •
- Department of Home Affairs
- Department of International Relations and Cooperation •
- Department of Higher Education and Training

ISSUES		
	ENGAGEMENT METHOD	OUTCOMES

<ul style="list-style-type: none"> <li>• Road shows to report on the turnaround strategy milestones</li> <li>• Engagement to report on the turnaround strategy milestones</li> <li>• Communicate the processes in place to strengthen governance, improve programme management, drive efficiencies and grow revenues</li> <li>• Update on the findings of Denel's forensic investigations <ul style="list-style-type: none"> <li>• Engagement to discuss collaborations</li> </ul> </li> <li>• Update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission</li> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>• Presentation of Strategic Integrated Programme to coordination structures</li> <li>• Attending Budget Votes of key government departments</li> <li>• Participation in government business delegations both local and International, IDEX 2019, LAAD 2019</li> <li>• Joint planning sessions and regular scheduled issue-specific meetings</li> <li>• Participation and visibility of key government officials in Denel's initiated stakeholder activities</li> </ul>	<ul style="list-style-type: none"> <li>• Some of the key relationships which were fractured are now regained and the levels of trust are improving</li> <li>• Rebuilding the relationship and increasing trust levels is ongoing and will continue into the next financial period. <ul style="list-style-type: none"> <li>• Strengthened relationship of mutual trust and support</li> </ul> </li> <li>• Support for Denel's business strategy and turnaround plan</li> <li>• Establishment of strategic partnerships with government departments and state agencies</li> </ul>
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## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 — MARCH 2020

### SHAREHOLDER GROUP

#### INDUSTRY PARTNERS AND CLIENTS

- National Defence Industry Council (NDIC)
- AMD
- SADI



- National Conventional Arms Control Committee (NCACC)
- Council for Scientific and Industrial Research (CSIR)

ISSUES	ENGAGEMENT METHOD	OUTCOMES
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<ul style="list-style-type: none"> <li>• Non-Payment of suppliers</li> <li>• Deregistration of Denel Asia</li> <li>• Engagement to report on the turnaround strategy milestones</li> <li>• Engagement with NCACC about end user certificates and permits</li> <li>• Communicate the processes in place to strengthen governance, improve programme management, drive efficiencies and grow revenues <ul style="list-style-type: none"> <li>• Update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission</li> <li>• Update on the findings of Denel's forensic investigations <ul style="list-style-type: none"> <li>• Engagement to discuss collaborations</li> <li>• Repositioning Denel as a custodian of core strategic and sovereign capabilities</li> </ul> </li> </ul> </li> <li>• Engagement to elevate product ranges, services, solutions and new capabilities</li> <li>• Engagement to influence policy direction, payments, projects and new business lobbying</li> <li>• To use business associations as a forum through which we can promote our viewpoints on key industry issues</li> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>• Frequent and structured interaction at monthly meetings with various industry bodies, AMD, NDIC, SADI</li> <li>• Monthly meetings with various industry bodies, AMD, NDIC</li> <li>• Presentations to various industry bodies, strategic committees, working groups and forums</li> <li>• SAAF-Denel Steering Committee meetings <ul style="list-style-type: none"> <li>• Client visits to Denel campuses</li> </ul> </li> <li>• Participation at international and local exhibitions and shows</li> <li>• Hosting of foreign delegations and defence attachés at Denel campuses</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiating with suppliers, in some circumstances, admitting liability in writing and undertaking to pay</li> <li>• Rebuilding the relationships and increasing trust levels is ongoing and will continue into the next financial year, as some of the key relationships were fractured and remained strained with low levels of trust</li> <li>• Weakened industry support for Denel's projects will need to be rebuilt</li> <li>• Restored relationships with increased support and collaboration</li> <li>• Denel's business strategy and turnaround plan is key and needs continuous support</li> </ul>
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## PART 3

### STAKEHOLDER ENGAGEMENT

#### STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 – MARCH 2020

##### SHAREHOLDER GROUP

##### SUPPLIERS/CREDITORS

ISSUES	ENGAGEMENT METHOD	OUTCOMES
		

<ul style="list-style-type: none"> <li>Engagement with suppliers to maintain support for Denel's business</li> <li>Denel's recapitalisation</li> <li>Engagement to report on the turnaround strategy milestones</li> <li>Engagement on the state of the Denel business and its impact on the non payment of suppliers <ul style="list-style-type: none"> <li>Update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission</li> <li>Update on the findings of Denel's forensic investigations</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Ongoing interaction with suppliers and contractors</li> <li>Frequent engagements at Denel's divisions</li> <li>Monthly and quarterly meetings</li> <li>Customer-specific operational meetings</li> <li>Industry networking sessions</li> <li>Participation and visibility of suppliers in Denel's initiated stakeholder activities</li> <li>Regular scheduled and ongoing engagements between the Group Exco and suppliers</li> </ul>	<ul style="list-style-type: none"> <li>Engagement to encourage responsible practices across Denel's supply chain, B-BBEE, local procurement, and environmental considerations</li> <li>Inclusion of critical suppliers in cross-functional teams as to contribute experience before specifications developed for products or services</li> <li>Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>Relationships with suppliers are strained due to non payment and weak communication</li> <li>Supplier business operations are halted due to suppliers' refusal to deliver parts without upfront payment</li> <li>Plans for strengthening these relationships to ensure continuity in the next financial year</li> </ul>	creditors

## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 — MARCH 2020

### SHAREHOLDER GROUP

#### INTERNAL STAKEHOLDER



- Organised labour
- All employees

ISSUES	ENGAGEMENT METHOD	OUTCOMES
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<ul style="list-style-type: none"> <li>• Denel's recapitalisation</li> <li>• Delay in salary payments and the non-payment of the pension fund contribution and other statutory obligations</li> <li>• Communication on the implementation of the voluntary severance packages (VSP) and application process</li> <li>• Appointment of the new executive management</li> <li>• Liquidity challenges <ul style="list-style-type: none"> <li>• Governance and leadership conduct, i.e. disciplinary processes instituted against former Denel executives, resignation of the Group Strategy Executive</li> </ul> </li> <li>• Engagement to give an update on the ongoing investigations of possible irregular expenditure, allegations of state capture and participation in the Zondo Commission</li> <li>• Providing staff with strategic direction and keeping them informed about Denel's activities; more particularly, in relation to Denel's turnaround plan milestones</li> <li>• Exiting Denel Aerostructures and LMT Holdings</li> <li>• Delivery of relevant business-orientated messages and campaigns on behalf of management</li> <li>• Employee training and development and transformation</li> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>• Road shows of Group CEO and senior executives</li> <li>• Engagement surveys, emails, intranet communications, infograms</li> <li>• A robust combination of face-to-face, written and broadcast communications <ul style="list-style-type: none"> <li>• Communication with employees through different platforms e.g. Tips for Danie, intranet and infograms</li> </ul> </li> <li>• Targeted employee events and celebrations of National Calendar Days as group</li> <li>• Impact making (effective) participation in relevant Denel events, strategic committees, working groups and forums</li> <li>• Participation and visibility of employees in Denel's initiated stakeholder activities</li> <li>• Regular meetings with organised labour and the Senior Leadership Forum</li> </ul>	<ul style="list-style-type: none"> <li>• Roadshows to introduce the new executives to employees</li> <li>• The process of rebuilding relationships is ongoing and needs to be strengthened through more transparent and trust-based engagements <ul style="list-style-type: none"> <li>• Employee buy-in for a short term rescue plan and a long term turnaround strategy is key</li> </ul> </li> <li>• Process of strengthening these relationships to continue into the next financial year</li> </ul>
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## PART 3

### STAKEHOLDER ENGAGEMENT

## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 –MARCH 2020

### SHAREHOLDER GROUP




<ul style="list-style-type: none"> <li>• Denel's recapitalisation</li> <li>• Advanced detailed discussions with lenders group to provide trade finance facilities that will significantly reduce operating losses</li> <li>• Major campaigns to the banks on Denel's guarantee</li> <li>• Liquidity challenges</li> <li>• Engagement to rebuild and strengthen relationships, get buy-in and support for the new strategy and turnaround plan</li> <li>• Future repositioning of Denel's divisions and products</li> </ul>	<ul style="list-style-type: none"> <li>• The Chairman of the Denel Board, executive directors supported by non-executive Board directors and the Shareholder embarked on intense interactions and meetings with financial institutions and investment partners</li> <li>• Local road shows to the banks and investment community</li> <li>• International roadshows to the investor community</li> <li>• Annual general meeting and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate the processes in place to strengthen governance, improve programme management, and efficiencies and grow revenues.</li> <li>• Update on the findings of Denel's forensic investigations company</li> <li>• Focus on project financing and requesting bank guarantees for major programmes without the need for back-to-back government guarantees</li> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>	<ul style="list-style-type: none"> <li>• The appointment of new Executive member (Group CFO) presented the company with new opportunities to communicate its key messages and positively profile the company</li> <li>• Extensive engagements with banks, providing detailed feedback on the identified projects and progress on strategic initiatives are ongoing</li> <li>• Process of</li> </ul>	and other in meeting
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## STAKEHOLDER ENGAGEMENT REPORT APRIL 2019 — MARCH 2020

### SHAREHOLDER GROUP

### MEDIA ORGANISATIONS / JOURNALISTS

ISSUES		ENGAGEMENT METHOD	OUTCOMES
<ul style="list-style-type: none"> <li>• Engagement to report on the turnaround strategy milestones</li> <li>• Introduction and profiling of the new Executive members (Group CFO)</li> <li>• Liquidity challenges</li> <li>• Government's guarantees to Denel</li> <li>• Denel's response and planning during the COVID-19 pandemic and lockdown</li> </ul>		<ul style="list-style-type: none"> <li>• One-on-one meetings with journalists and editors</li> <li>• Media roundtable with Denel's leadership</li> <li>• Denel open days</li> <li>• Media interviews, statements and responses</li> </ul>	<ul style="list-style-type: none"> <li>• Strained relationship with reduced trust levels</li> <li>• Reduced trust and credibility in Denel voices</li> <li>• The appointment of a new Executive members (Group CFO) presented the company with new opportunities to communicate its key messages and positively profile the company</li> <li>• Process of strengthening relationships that support</li> </ul>




the business towards sustainable growth is ongoing and will continue into the next financial year

PART 3

STAKehOIDeR eNGAGeMeNT


MATeRIAl ISSUeS



- Issues at divisional EXCO
- Group Board meetings
- Stakeholder engagements

IDENTIFYING MATERIAL ISSUES

- Based on risk and opportunities
- Materiality



- Impact issue will have on Denel
- Identify mitigation actions
- Implement actions that will manage material public both locally and globally regarding responsible manufacturing, the transfer of arms and ethical business conduct. Consequently, stakeholders place a high premium on sound corporate governance and regard effective risk management as a key strategic driver.

matters

- Report at regular Board meetings
- Monitor against Shareholder's Compact
- Monitor against performance targets

Denel designs, develops and offers defence and security solutions and services to the SANDF, the country's law enforcement agencies and the growing and highly competitive export markets. Additionally, Denel is strategic and critical to the state's objectives of balanced economic development. Denel is part of the global supply chain and conducts its business through a variety of suppliers, other business partners locally and access to export markets. The company depends on complex logistics to receive components and subsystems and to deliver to its customers. Defence contracts are generally complex and of a long-term nature and involve high working capital and continuously changing technology.

Political, economic, social, technological, legal and environmental events impact on Denel's risk profile. Denel is subject to scrutiny by regulators and the

Denel has adopted an enterprise-wide risk management approach. Denel's risk management framework is a combination of the principles contained in the Committee of Sponsoring Organisations of the Treadway Commission (COSO) and ISO31000 principles and is aligned to the nature of its business, architecture and culture.

Denel has also adopted ISO9001 and ISO14001, OHSAS18001 on which quality, occupational health, safety and environmental management systems are based as part of the risk management system. Information technology (IT) risks are addressed through the IT governance framework and policy, and managed at business unit level.

Financial and operational controls, governance and internal audit processes are integrated to cover the



full spectrum of risk and risk mitigation measures that the organisation faces.

The Board is ultimately responsible for risk governance and has assigned risk oversight to the Risk Committee, which is supported by the Audit Committee, Social and Ethics, Finance and Investment and Personal, Recruitment and Transformation committees on pertinent issues. This ensures an integrated approach to risk oversight based on enterprise-wide risk management, and a

focused approach on integrity to preserve ethical business conduct. This assures effective and efficient capital allocation and investment in projects that deliver returns for the shareholders, efficient human capital that builds and maintains critical skills and a motivated workforce, and provides assurance regarding the effectiveness of internal control.

EXCO is responsible to the Board for the system of risk management, including approving policy and the strategic risks of the organisation.

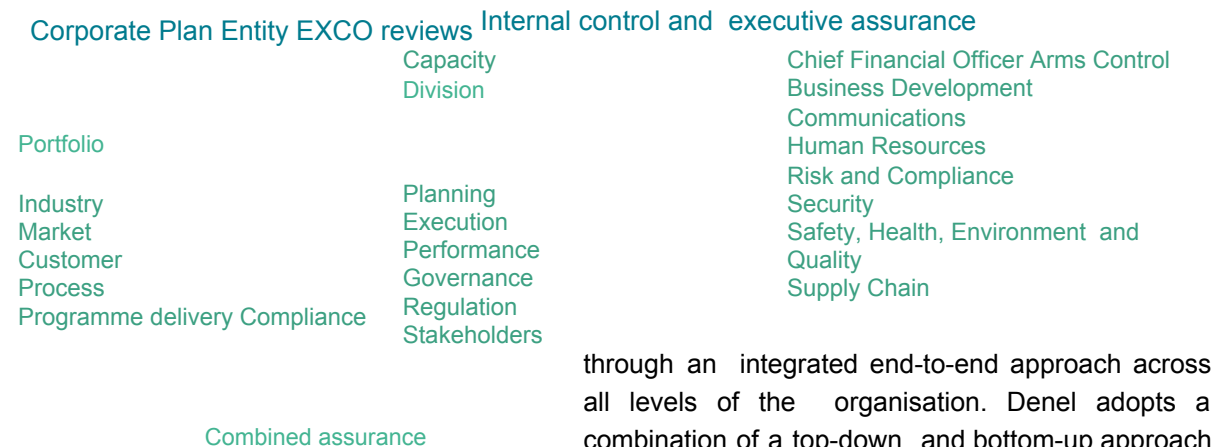
COMMITTEE

SOCIAL AND ETHICS

PERSONNEL, REMUNERATION AND TRANSFORMATION

COMMITTEE AUDIT COMMITTEE EXECUTIVE

CORPORATE PLAN EXCO REVIEWS FUNCTIONAL FORUMS



through an integrated end-to-end approach across all levels of the organisation. Denel adopts a combination of a top-down and bottom-up approach to risk assessment and uses business units and the Group EXCO's risk assessments to develop the group's strategic risk profile. Biannually, EXCO's undertakes a rigorous strategic planning process, which includes the identification of risks and opportunities. The process includes the review of operational, human resources, products, business development, order cover, balance sheet, business

RISK IDENTIFICATION AND ASSESSMENT

Denel continuously identifies and assesses risk

performance and major events during the strategic review period.

Denel or the industry. Denel assesses all material events, activities and decisions that may impact on its objectives. Denel has put processes in place to assess risk and implement mitigation measures with regard to acquisitions and disposals, new opportunities and regulatory changes. Denel promulgated a specific policy to ensure effective country risk management to mitigate credit risks as part of financial risk management, which is discussed at length on page 202.

Risk assessment is also triggered by internal, external, local and global events that have affected

PART 3  
STAKEHOLDER ENGAGEMENT

PRIORITISE AND RESPOND

A comprehensive risk register is developed with risks quantified according to probability and impact, mitigation measures and the allocated risk owners. Risks are broadly categorised according to financial, programme, human resources, safety, environmental, technology and other classes. An update is tabled at the Risk Committee for discussion and review. A summary of the top significant risks is given below.



NO	RISK NAME	DESCRIPTION	CONTROLS			
	Competing stakeholder expectations and interests	Competing objectives of critical stakeholders regarding the strategy of the company	Strategic stakeholder engagement Regular meetings of set committees to articulate strategy and the status of turnaround actions and alignment regarding Denel's strategy	6	Supply chain	Single/sole source suppliers, material requirements planning and incurrence of unauthorised, irregular and fruitless and wasteful expenditure
				7	Loss of public and market confidence and reputation	Loss of public and market confidence reputation
	2	Solvency and liquidity	Weak balance sheet and cash constraint to fund operations and growth	Domestic Medium-term Note Programme Funding Strategy: Shareholder's financial assistance (government guarantees) Short-term funding from lenders Restructuring and disposals		

NO	RISK NAME	DESCRIPTION	CONTROLS
8	Changing regulatory environment	Failure to comply with legal and regulatory requirements resulting in punitive action and bad reputation	Monitoring changes in the legal and regulatory environment Maintenance of registers for critical laws and regulations Clear and structured processes for approval of material transactions Maintaining open communication channels with relevant regulatory bodies
9	Security of assets and information	Theft, vandalism or unauthorised use of assets wrongful exploitation of proprietary information	Security vetting Information and communication technology (ICT) security measures Physical measures, access and asset control Improving information security
10	Fraud and corruption	Criminal deception for financial or personal gain and /or giving or accepting bribes and reputational damage	Whistle-blowing programme Employee ethics programme Management of personal interests Anti-bribery and corruption prevention programme Anti-fraud and ethics awareness programme

#### MITIGATION OF THE MOST SIGNIFICANT RISKS

Material issues that could affect Denel's ability to deliver on its strategy receive priority attention. Denel follows a process that seeks to manage and reduce risk for internal financial and operational advantages and a competitive advantage in every area of the organisation. Risk mitigation strategies are integrated into strategic and operational activities, processes and policies of the group.

**Denel recognises the complexities of operating in a contract environment and has implemented processes to manage programme risks throughout the contract life cycle of pre-proposal, proposal, design, development and execution at each business unit. The process includes high levels of project risk management.**

Denel recognises the complexities of operating in a contract environment and has implemented

processes to manage programme risks throughout the contract life cycle of pre proposal, proposal, design, development and execution at each business unit. The process includes in-depth project risk management.

Business-specific risks are strategically integrated within business units to ensure mitigation threats at source. During the year under review, Denel placed emphasis on bid reviews and interrogation of assumptions, profitability, cash flow, foreign exchange rate, cost of borrowing, return on investment and pursuing suitable funding options. The objectives are to strengthen the balance sheet and reduce the cost of capital. Supply chain and programme delivery inefficiencies have a direct impact on operational efficiency, profitability and cash availability in the company. Measures have been put in place to improve efficiencies in the supply chains to ensure that the procurement of goods and services is cost effective and timely. Denel will continue to assess and identify opportunities to improve efficiencies across the value chain. Appropriate dashboards have been implemented to monitor programme delivery with more emphasis on programme cost management, delivery schedules, quality control and inventory management.









# eNVIRONMeNT AND STRATEG<sup>Y</sup>

54 DeNeI GROUp INTeGRATeD RepORT 2019/2020

PART 4

## eXTeRNAI eNVIRONMeNT AND STRATeGY

### LOCAL ENVIRONMENT

Denel has always maintained that the primary purpose for establishing the company was to support the activities of the local customer, which is the SANDF. The local customer is our most important partner constitutes 58% (2018/19: 49%) of the revenue. The local client base assists in key product developments, which Denel leverages when pursuing foreign business initiatives. The current defence and security budget is 1.1 % of the gross domestic product (GDP), which is low compared to international norms, sitting at around 2,5%. While the relatively low defence spend places pressure on Denel to find export clients to maintain capability and be sustainable, it provides a base load, together with investment in new technologies. The technology is important when pursuing export business. The export business provides critical mass to sustain strategic and sovereign defence capabilities. The strategic alignment between the



DoD/SANDF and Denel ensures that the approved Defence Review Policy (2015) implementation achieves its stated objectives. The local defence budget has been continuously cut and many fewer projects and defence activities are available in the local market. The South African defence markets have therefore been depressed for a number of years, with the last major capital expenditure projects being for patrol vessels, which are also slowly coming to an end. No major exciting capex projects are on the immediate horizon.

### EXPORT ENVIRONMENT

Denel, as well as the rest of the South African defence industry, increasingly has to put its focus and efforts on winning export contracts for its continued survival. Denel and the rest of the SADI have always fielded a niche market where customers would not buy from the European, USA or Israeli suppliers. Denel, however, has too much

reliance on the Middle East countries and should further expand and spread the risk by expanding to the Far East, South Asian and Latin American markets.

Stronger competition with European and USA companies should be expected in markets traditionally serviced by Denel due to contraction in defence spending in their home markets. It is further expected that customers will shift their focus from procuring systems with the highest possible performance to ones that are more affordable. In addition,

lower oil prices are likely to affect the cash reserves of some countries and their spending patterns on defence going forward.

Despite these factors, Denel is experiencing a strong demand for its products in the growth markets of Asia-Pacific and the Middle East. These markets are currently the main export customers for Denel's products. There are a number of new business opportunities expected to be concluded and executed in the short to medium term. South Africa is well positioned through its foreign relations in these regions. The existing political support from government and its agencies enjoyed by Denel facilitates business development in these markets.

Business opportunities on the African continent remain largely untapped due to ill-defined user requirements, funding constraints and other hindering dynamics, most of which are political.

There are, however, gaps to fill and opportunities to pursue, specifically in the West-African region.

Denel is in good standing with the United Nations, which provides access to humanitarian and peace-keeping initiatives, with some contracts currently being executed. The Latin American region is still heavily invested in acquisitions of weapon systems and, despite defence cuts, still offers opportunities for Denel. The poor economic outlook for this region is, however, expected to further erode market opportunities.

The global supplier base became an important value creation element to secure export business. To be successful in international markets requires localisation of capability and technology. Denel is well positioned with its networks through equity and strategic partnerships to take advantage of this trend.





Capital structure:	Resolve and strengthen balance sheet weaknesses Optimise supply chain and reduce costs to	increase productivity and competitiveness Order book: Establish new markets, rebuild existing	relationships and foster stakeholder alignment Exit non-core business and create strategic	partnerships Retain and rebuild core capabilities to focus position in the value chain
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## Implement transformation of people management and processes throughout the organisation

### KEY STRATEGIC INTERVENTIONS

- Complete governance and compliance improvements
- Develop commercial/entrepreneurial mindset
- Strengthen balance sheet and liquidity position
- Retain core skills and appoint right calibre of leadership
- Implement supply chain optimisation programme across Denel
- Secure market access and generate cash through strategic equity partnerships
- Exit from loss-making and non-core businesses
- Improve efficiency through focused programme management, cost-reduction management and properties/facilities optimisation





# PERFORMANCE REVIEW<sup>W</sup>



technology



Group  
CEo'S

REPOR  
T



*industries locally, Denel is committed to its efforts to transform the organisation into a sustainable defence and advanced manufacturing company.*

The South African market, and the SANDF in particular, remains the most important market for Denel. The national defence market and SANDF's budget remains under extreme pressure with no immediate dramatic recovery expected. Other opportunities in the national security market and export opportunities are to be pursued in order to reach targets of a healthy order book. Denel has reviewed and identified the funding gap that remains in order to retain its sovereign and strategic capabilities.

Working with its stakeholders in the aerospace, maritime and defence industries, it endeavours to strengthen and restore the country's defence

industry to its long-held position of excellence. By supporting the SANDF and capitalising on the global growth in demand for defence systems and products, Denel is confident that it will retain its position as a strategic national asset.

During the period under review, Denel responded to the imperatives posed by the economic, social and natural environment in which it operates in accordance with its commitment to sustainable development principles.

These principles are embedded in the group's corporate strategy and values, and are reflected in the financial and economic decisions made by the group. As such, it embraced the following values to navigate through the challenges it is experiencing:

- Integrity: We are honest, truthful and ethical. We will always act in Denel's best interests.
- Courage: We are willing to challenge and make difficult decisions, and to push through uncomfortable situations.
- Performance: We strive for excellence in all that we do.
- Accountability: We take ownership for our actions and behaviour.

Denel's management and staff are committed to practicing these values daily, as they present an opportunity to renew and focus on the task at hand.

#### Strategic intent

The company's strategy is aligned to its purpose statement, which is to provide turnkey solutions of defence, security and related technology to its clients by designing, developing, integrating, testing and evaluating, and supporting artillery, armour-protected vehicles, missiles munitions, unmanned aerial vehicle systems, aircraft maintenance and aerostructures based on high-end technology, effectively and efficiently.

As part of Denel's turnaround strategy approved by the Board in 2018, the company embarked on a process to exit unprofitable, non-core businesses. This created the opportunity to acquire strategic equity partners, which will enable Denel to secure

market access and generate cash, thereby restoring its financial sustainability. It is also engaging with interested parties for equity injections.

## PART 5 PERFORMANCE REVIEW

Key strategic interventions that formed part of the company's activities during the period under review therefore included the following:

- Complete governance and compliance improvements
- Develop a commercial/entrepreneurial mindset
- Strengthen the company's balance sheet and liquidity position
- Retain core skills and appoint the right calibre of leadership
- Implement a supply chain optimisation programme across Denel
- Secure market access and generate cash through strategic equity partnerships
- Exit from loss-making and non-core businesses
- Improve efficiency through focused programme management, cost reduction management and properties/facilities optimisation

### Stakeholder engagement

Denel has continued to place stakeholder engagement at the centre of its business and delivery model. This element of its operations is gaining increasing importance as Denel implements its turnaround strategy, and implements efforts to rebuild confidence among its clients and stakeholders.

Political, economic, social, technological, legal and environmental events impact on Denel's risk profile. It is subject to scrutiny by regulators and the public, both locally and globally, regarding responsible manufacturing, the transfer of arms and ethical business conduct. Consequently, stakeholders place a high premium on

sound corporate governance and regard effective risk management as a key strategic driver.

### riSk management

Financial and operational controls, governance and internal audit processes were integrated to cover the full spectrum of risk and risk mitigation measures that the organisation faces. The most significant risks encountered during the period under review included the following:

- Competing stakeholder expectations and interests
- Solvency and liquidity (a weak balance sheet and cash constraints to fund operations and growth)
- Programme delivery slippages and cost overruns as a result of poor programme contracting and poor programme management
- Business interruptions brought about by the adverse impact of COVID-19 on employees and the company's operations

- Loss of core skills and knowledge



through the loss of key leadership, resources and institutional knowledge

- Supply chain risks related to single/sole source suppliers, material requirements planning and the incurrence of unauthorised, irregular and fruitless and wasteful expenditure

- The loss of its public and market confidence reputation
- Continuously changing of and red-tape in the regulatory environment
- Physical and cyber security risks
- Fraud and corruption

Business-specific risks were strategically integrated within business units to ensure that risks are attended

### DENEL GROUP INTEGRATED REPORT 2019/2020 59

to at the source. During the period under review, Denel emphasised bid reviews and interrogating assumptions, profitability, cash flow, the foreign exchange rate, cost of borrowing, return on investment and pursuing suitable funding options.

The most important risk that has been threatening the sustainability of the organisation over recent years is the liquidity challenge it is experiencing. This has brought about the need to implement operational and structural reforms, including the securing of strategic equity partnerships in its businesses to secure markets and capital access, and technology development. In the process, Denel is positioning its divisions as stand-alone, client-centred businesses, while driving a strong focus on operational excellence and courageously rolling out a transitional set of values.

Liquidity management forms the most important element of Denel's stabilisation strategy. As such, Denel continued to engage the Department of Defence to secure funding to protect its strategic and sovereign capabilities, and monitored its cash flow through the Finance and Investment Committee, Audit Committee and Board meetings, as well as meetings with National Treasury and the Department of Public Enterprises, as representative shareholder. Furthermore, ongoing engagement took place with Denel's lenders, and with creditors and suppliers on deferred payment plans.

### Financial overview and Funding

The 2019/20 financial year proved to be another challenging year for Denel, with a total comprehensive loss of R1.962 billion for the year, compared to a loss of R1.469 billion (restated) in the previous year. This net loss can primarily be attributed to a delay in sales,

an inefficient cost structure and poor programme execution. Denel has further been negatively impacted on by reduced margins due to labour under-recoveries as a result of lower operational activities and little to no production activity.



In August 2019, Denel received R1.8 billion in recapitalisation from its Shareholder. This was utilised to repay long-overdue creditors, settle debt and restart operations that had slowed down significantly due to suppliers requesting upfront payments under certain circumstances. Despite the recapitalisation, Denel's cash flows from operations remained negative at R811 million in delayed deliveries to customers due to poor contract and working capital management. However, taking various factors into account in the evaluation of the consolidated annual financial statements, including management's radical action plans and mitigating actions to improve Denel's performance and solvency position during the next 24 months, the directors are satisfied that Denel will continue to operate as a going concern, while it looks forward to assistance from its Shareholder in the identification and management of risks.

#### implicationS of the covid-19 pandemic

Although the COVID-19 pandemic related to liquidity challenges that materialised after reporting period, divisions and subsidiaries of Denel concluded the financial year by assessing significant accounts that will likely be impacted on by the pandemic. Following South Africa's first recorded case of the disease in early March 2020, government declared a national disaster and the country went into a hard lockdown from 27 March 2020 to 16 April 2020. This was subsequently extended to 30 April 2020.

This hard lockdown meant that the whole country was shut down, inclusive of its borders, with the exception of certain essential services that could continue operating. This had a severe impact on the economy, and also further exacerbated Denel's liquidity situation. This impacted on production and also on the payment of salaries for the months of April to July 2020, with net salaries for the months of May to July not being fully paid to employees, and the payroll third-party statutory payments not being paid from April to July 2020.

#### operational highlightS

Denel's business divisions recorded several highlights during the year. Denel Dynamics' Cheetah counter rocket, artillery and mortar missile development work for the year

was successfully completed with the conclusion of the System Requirements Review. In addition to the approval of the system and subsystem requirement specifications, a programme management baseline was also reviewed and accepted.

Denel Land Systems delivered the 100th modular turret for armoured vehicles used by the Malaysian armed forces in terms of a multi-million rand export contract. A thermal imager test and repair facility was inaugurated at Defence Services Sdn Bhd (DSSB) in Nilai, Malaysia. This is the first of its kind in Malaysia and was proudly made possible by Denel.



During the latter part of 2019, DVS signed a significant vehicle contract with a customer in the UAE for the manufacture of 33 RG31 vehicles with the potential for future orders.

#### appreciation

I am grateful to the Shareholder for its continued support of Denel during this difficult time. The funding for recapitalisation should be seen as support for the quality of its turnaround strategy and a commitment to the future of a strategic asset.

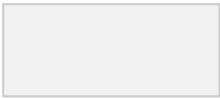
I also wish to extend a word of appreciation to the Minister of Public Enterprises, Mr Pravin Gordhan, for his strategic guidance. Denel continues to value its close relationship with the Department of Public Enterprises, the Department of Defence and Military Veterans, the SANDF, Armscor and the wide range of stakeholders in the defence and technology sectors.

The Board of Denel, under the leadership of Ms Monhla Hlahla, has played a vital role in providing leadership to the company and its business units.

Finally, I recognise each and every staff member of the organisation. The fundamental and much-needed changes that are required to stabilise Denel would not be possible without the support of

such a capable and loyal workforce.

Talib Sadik  
Interim Group CEO



PART 5  
PERFORMANCE REVIEW

OPERATIONAL  
REVIEWS

DENEL  
AERONAUTICS

and sale of 12 Cheetah fighter aircraft to Draken International, USA, known as Project Dragon, reached its first millstone with the delivery of the first two aircraft to Draken International on 18 October 2019.

- Exist and winding up of Denel Aerostructures: As part of the exit and winding up of Denel Aerostructures SOC Ltd, the Ribs Spars and Sword work package

NUMBER OF EMPLOYEES

- 
- Maintenance of current certifications and accreditations: Despite difficult trading conditions, Denel Aeronautics was able to maintain current certifications and accreditations from various external bodies and regulators such as the International Standards Organisation (ISO) and the aerospace standard with Bureau Veritas International, Aircraft Maintenance Organisation approvals with the South African Civil Aviation Authority, environmental and occupational health and safety standards by the South African Bureau of Standards, aerostructure manufacturing standards with the National Aerospace and Defence Contractors Accreditation Programme (NADCAP) and aircraft and subsystem OEM accreditations with Airbus Helicopters, Lockheed Martin, Russian Helicopters and Safran Helicopter Engines.
  - Relationships with key customers: Relationships with key customers, suppliers and other critical stakeholders was maintained to enable the execution of projects.
  - Project Dragon: The return to service

805


	R'm	R'm	%
Revenue	770	720	7%
Export	146	125	-16%
Earnings before interest and taxation	-61	17	-452%

AERONAUTICS GROUP



was successfully transferred as part of the transfer of 400 million work

packages in September 2019, along with two work packages for other customers. With the winding up of Denel Aerostructures, it was contemplated that 230 employees would be retrenched. Through redeployments within the Denel Group, this number was reduced to 177 retrenchments, 58 of these being voluntary retrenchments.

- Armscor product and supply contracts: The sustainment of the C130, Oryx and Rooivalk was enabled as contracted through the product supply support contracts with Armscor for the South African Air Force with airworthiness assurance.

- Denel Training Academy: The DTA completed training for the Cameroon Air Force with 117 learners successfully completing their aircraft trade studies. Furthermore, 38 learners from North West were successfully handed over to their sponsor, the North West Provincial Government, to complete on-the-Job training after completion of their initial theoretical training. The last 90 students

co sponsored by Denel and the National Skills Fund will complete their on-the-





Earnings before interest and taxation	-272	-480	-43 %
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## DENEL DYNAMICS

- A-Darter: The A-Darter missiles successfully completed the missile qualification and certification for its leading fifth-generation imaging infrared short-range air-to-air Missile.
- Cheetah: The Cheetah counter rocket, artillery and mortar missile development work for the year was successfully completed with the conclusion of the System Requirements Review. In addition to the approval of the system and subsystem requirement specifications, a programme management baseline was also reviewed and accepted.

- Seeker 400: The unmanned aircraft system achieved its interim military type certification and is currently in operational test and evaluation with the end user.



### NUMBER OF EMPLOYEES

535

	R'm	R'm	%
Revenue	350	358	-2%
Export	161	136	19 %

### DYNAMICS

GROUP Denel Dynamics

PART 5  
PERFORMANCE REVIEW

DENEL LAND  
SYSTEMS

• The Hoefyster Integrated Programme Team: This team, consisting of Armscor, the South African Army and DLS has concluded the section variant product baseline with an accepted functional configuration audit.

• DLS Software Qualification Team: This team successfully developed and qualified software in the Battle Management Computer for the section variant of the Hoefyster Programme to comply with the objectives of RTCA/DO178B Design

Assurance Level C. Armscor audited this software with no findings raised.

• Modular turret for armoured vehicles: DLS delivered the 100th modular turret for armoured vehicles used by the Malaysian armed forces in terms of a multi million rand export contract.

• Thermal Imager Test and Repair Facility: A Thermal Imager Test and Repair Facility was inaugurated at Defence Services Sdn Bhd (DSSB) in Nilai, Malaysia,

NUMBER OF EMPLOYEES

507

DENEL GROUP INTEGRATED REPORT 2019/2020 63

	R'm	R'm
Revenue	876	1 597
Export	589	1 020
Earnings before interest and taxation	-265	-293

This is the first of its kind in Malaysia and was proudly made possible by Denel

• Eastern Border Demining Project: This has been a unique project to be conducted in such manner in Turkey. The project started in 2016 and was completed in 2019, well before the anticipated time. More than 45 000 landmines were lifted from not less than 39 minefields under difficult circumstances, ranging from the terrain itself, the government and the client. Only three non-fatal incidents were recorded in the four years of operations under the said circumstances. This project proved to make history in the mine action space, where operations of this calibre were undertaken. Mechem

once again proved its unmatched character and attitude in Turkey and Europe at large.

SYSTEMS

Denel Land Systems GROUP

DENEL LAND

DENEL VEHICLE SYSTEMS (PTY) LTD

- Delivery of RG12 Mk6 prototype: The RG12 Mk6



prototype vehicle was delivered to the customer in the UAE, who was very impressed with the vehicle. This could potentially unlock future

opportunities.

- Manufacturing contract for RG31 vehicles: During the latter part of 2019, DVS signed a significant vehicle contract with a customer in the UAE for the manufacture of 33 RG31 vehicles with the potential for future orders.
- Denel Gear Ratio: This business unit has been successfully qualified to be a supplier of pinions through a First Article Inspection process for Transnet's 1 064

NUMBER OF EMPLOYEES

392

	R'm	R'm	%
Revenue	176	355	-50 %
Export	106	199	-47 %
Earnings before interest and taxation	-266	-236	13 %

locomotives project. Denel Gear Ratio continues to experience substantial reduction in spares and repair sales, contributing to poor delivery performance to critical customers. This has subsequently created the risk of losing this entire business stream to competitors.

- In-flight test services: In-flight test services were provided to the SANDF in terms of a multi-year contract with the Department of Defence and Military Veterans. DVS successfully supported all the required projects of the Department of Defence as a knowledgeable buyer and user of equipment.



DENEL VEHICLE  
SYSTEMS

Denel Vehicle Systems (SOC) Ltd GROUP

DENEL OVERBERG

- In-flight test services: In-flight test services were provided to the SANDF in terms of a multi-year contract with the Department of Defence and Military Veterans. OTR successfully supported all the required projects of the Department of Defence as a knowledgeable buyer and user of equipment.
- In-service and development tests: OTR provided essential support to DLS and Rheinmetall Denel Munitions for various in-service and development tests.
- Singapore Air Force: OTR conducted a test campaign for the Singapore Air Force, which is an established international client of OTR.
- Marketing: OTR hosted a very successful “show and tell” event on the current test range’s capability updates and demonstrated the capability with a real test to various of its stakeholders.
- Overseas visit: OTR visited Europe to renew relationships with established clients and to discuss future test requirements with new and current clients.
- Accreditation: OTR maintains the ISO9001:2015 standard. This ensures that it complies with the quality standard and ensures clients’ satisfaction at all times.



Earnings before interest and taxation	28	3	926 %
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- Hangar support: OTR assisted the Overberg Air Force Base with hangar support for its helicopters during the upgrade of the facility on the base.
- Power back-up: The OTR’s main generator power back-up system feeds the Overberg Air Force Base as well, and was serviced to improve reliability during Eskom loadshedding periods.
- Software upgrades: The data processing software system was upgraded and accepted by using OTR’s internal expertise and capabilities.
- Instrumentation and infrastructure upgrades: Various upgrades and renewals were done to OTR’s instrumentation and infrastructure:
  - Procurement and installation of a pressure waveguide dehydrator at the tracking radar
  - Procurement of an intrinsically safe multi-meter for the explosives area
  - Refurbishment of optic lenses for various instrumentation systems
  - Procurement of new standard time code generation units
  - Procurement of a new forklift for the explosives area.



NUMBER OF EMPLOYEES

139

	R'm	R'm	%
Revenue	132	94	41 %
Export	53	14	285 %

DENEL  
OVERBERG TEST  
RANGE

PRETORIA METAL PRESSINGS

- Multipurpose Ammo Project: The 20 x 139 Multipurpose Ammo Project, conducted in collaboration with Nammo, has been successfully concluded for SANDF and is now a qualified PMP product.
- Product and process qualification: The product and process qualification of the 20 x 139 mm multipurpose rounds was completed with the participation of Armscor,



taxation			
----------	--	--	--

the SAAF and SANDF’s Chief Technology Office in Pretoria. This is a joint milestone for both PMP and Nammo as it was the first PMP/Nammo collaboration where 6 053 20 x 139 mm multipurpose rounds were delivered to the SANDF in March 2020. A follow-up order for 5 000 rounds was successfully tendered for and is scheduled for delivery before March 2021.



NUMBER OF EMPLOYEES

783

	R'm	R'm	%
Revenue	179	225	-20 %
Export	65	71	-8 %
Earnings before interest and	-224	-213	-5 %

PRETORIA  
METAL  
PRESSINGS

## PART 5 PERFORMANCE REVIEW PART 5

## FINANCE REVIEW



### OVERVIEW



Group revenue reduced by 20% to R2.72 bn (2018/19: R3.40 bn), driven by liquidity constraints, as Denel battled with low funds to meet all its operational requirements in during the year. This impacted on the payment of suppliers, therefore on time deliveries to customers. Although the recapitalisation received on 31 August 2019 boosted liquidity and the ability to

deliver to clients, it also came with the following conditions:

- Denel must be tax compliant by ensuring that where taxes have been deducted from employees, these

7 000 6 000 5 000 4 000 3  
000 2 000 1 000 -

6 023

### REVENUE

3 400

taxes are paid over to the South African Revenue Services (SARS);

- Critical suppliers are paid to enable the restart of operations;
- Denel should repay the bank loans that had been provided under the R1 bn government guarantee.

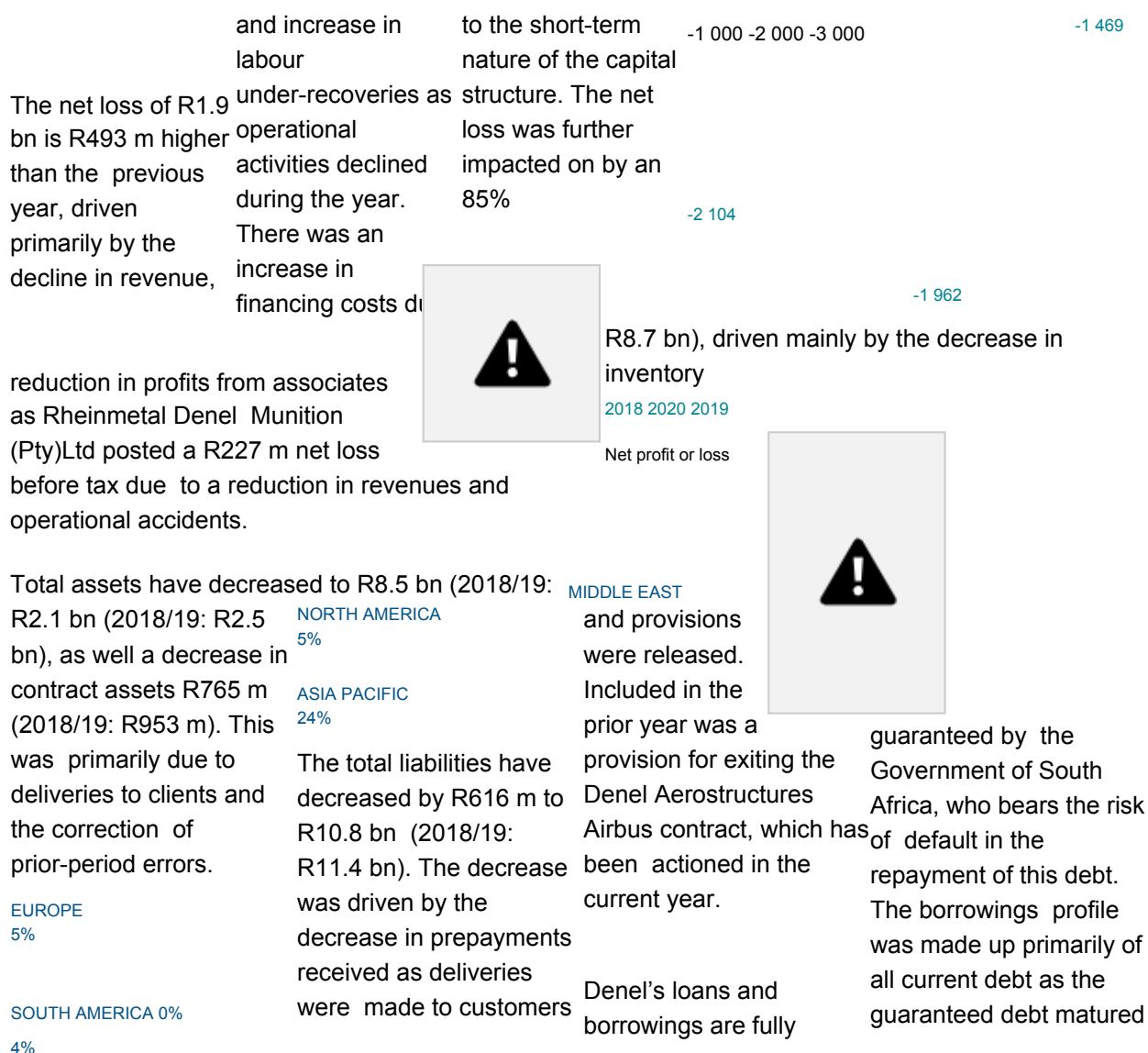
While Denel met its statutory commitments and the conditions, the amount was not enough to achieve the previous year's revenue levels and targets set for 2019/20. This has affected all divisions within the group, except for the Overberg Test Range, which has managed to maintain its revenue year on year.

The operating loss of R1.5 bn was mainly driven by the lower revenue-generating operating activities, leading to an increase in labour under-recoveries and forex losses on exports.

Net financing costs remained high at R576 m (2018/19: R618 m restated) as Denel continues to rely on debt to finance its operational costs. In compliance with IFRS15, the finance cost also includes the significant financing component amount from advance payments received from customers of R226 m (2018/19: R248 m).

## 68 DENEL GROUP INTEGRATED REPORT 2019/2020

## PART 5





in September 2020. As at 31 March 2019/20, Denel was insolvent by R2.3 bn. This was driven by the losses incurred since 2017/18. On

Sales by

Destination 2020

SOUTH AFRICA  
58%

3165

	3 500	<del>3240</del> AFRICA 4%	
	3 000		
	R1.8 bn in	the solvency position.	1995
31 August 2019, the	recapitalisation funds	This funding	1722
Shareholder approved	to re-stabilise the	2 500 2 000 1 500	<del>4270</del> 2496
and paid to Denel	business and improve	2412	
		and debt financing costs, and	<del>800</del> 853
		implement strategic actions in the	
		turnaround plan.	311 <del>433</del> 438
injection was utilised to restart	1 000 500		
operations, pay overdue taxes	-		

2016 2018 2020 2015 2017 2019

Non-current borrowings Current borrowings

DENEL GROUP INTEGRATED REPORT 2019/2020 69

## PART 5 PERFORMANCE REVIEW

### DISCLAIMER AUDIT OPINION

In the current financial year, the Auditor-General has issued a disclaimer audit opinion based on the matters that Denel had not been able to sufficiently resolve with respect to the 2017/18 and the 2018/19 opinions and additional findings with respect to 2019/20 as detailed in the Auditors Report. During the current

financial year, management implemented a project in which the new accounting standards have been implemented in a uniform manner throughout the group and it has updated all financial records to ensure adherence to the standards. In some instances, management did not agree with the auditors on judgements made in implementing IFRS 15. This has, in the main, contributed to the disclaimer audit opinion as a number of related financial statement accounts also impact on the revenue amounts determined by management as per the contracts Denel has with its customers. Furthermore, at year-end, due to the

significant number of prior-period errors that required correction to each monthly reporting period, the consolidated financial reporting tool became unstable and, although mitigating steps were taken to prepare the annual financial statements, these were inadequate to completely deal with the full impact on the group's consolidation.

In resolving the matter Denel has considered various key actions to improve the audit opinion, including the following:

- Implementing a new reporting tool in



order to ensure accurate and complete compilation of the annual financial statements.

- Identifying key appointments of relevant competent staff in finance with the relevant experience and expertise.
- Further engagements with the auditors in order to deal with the areas of disagreement with management, particularly in the areas where management has the discretion to apply judgement based on their knowledge of the business, the industry and history.
- Agreement on what further improvements the auditors require on Denel's business process documentation to enable the auditors to audit its systems.

## BUSINESS OUTLOOK

Denel continues to provide a strong and innovative technology base to provide

an independent defence industrial capability and supports the mandate of a modern, balanced and technologically advanced SANDF that is required to protect the economic growth and security of the Republic of South Africa.

The global defence industry is expected to decline as the world economy deals with the impact of the COVID-19 pandemic. The full impact is not yet fully appreciated; however, we expect a further decline in the defence budget as some countries realign their available resources.

Furthermore, the stagnant domestic defence budget (which has declined from 1.5% of GDP in 2013 to less than 1% of GDP currently), including the discontinuation of the Special Defence Account from the 2020/21 financial year, means that Denel and the SADI have to look increasingly outwards for growth. Denel's position is supported

by its substantial order book of circa R13 bn. The business focus going forward includes the implementation of the turnaround strategy, sourcing funding and improving operational performance.

The turnaround plan was developed to effectively respond to these realities and includes a solid focus on:

- Growing the order book of the business and finding new revenue streams.
- Further reducing the cost base to be aligned with anticipated business volumes.
- Concluding strategic equity partners in terms of a defined process as required by the Shareholder to increase access to technology, markets and capital.
- Selling off the remaining non-core businesses.
- Reducing debt to normalise the capital structure of the company and strengthen its balance sheet.











# HOW WE ARE GOVERNED

As a state-owned company (SOC), Denel's sole shareholder is the South African government. The Shareholder representative, the Minister of Public Enterprises, appoints a Board of Directors to oversee the functioning of the company's executive management. The company is, in essence, a group comprising business units and divisions, as well as associated companies in which Denel has shareholding of varying degrees.

The Board commits itself to apply and enforce applicable corporate governance principles. It further recognises that sound corporate governance enhances the long-term sustainability of the company and provides assurance to its stakeholders that the company is well managed. Risk management and internal control systems are in place, which are designed in accordance with best practice and in compliance with the recommended principles contained in the King Report on Governance (King IV report), as well as the statutory requirements contained in the Companies Act, No. 71 of 2008 (Companies Act), as

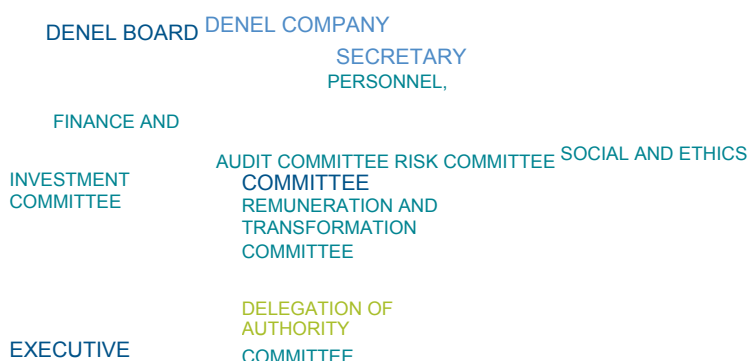
amended, the Public Finance Management Act, No. 1 of 1999 as amended by.

The Public Finance Management Amendment Act, No. 29 of 1999 (PFMA) and the National Treasury Regulations.

The Board consists of the following committees:

- Audit Committee

- Risk Committee
- Finance and Investment Committee
- Personnel, Remuneration and Transformation Committee
- Social and Ethics Committee



## DENEL HAS THE FOLLOWING FORUMS SUPPORTING THE BUSINESS:

- |                             |                  |                                |
|-----------------------------|------------------|--------------------------------|
| • CFO Forum                 | HR Forum         | Forum                          |
| • Supply Chain Forum        | • Security Forum | • Transformation Forum         |
| • Risk and Compliance Forum | • Legal Forum    | • Group Communications Forum   |
| • Arms Control Forum        | • SHEQ           | • Business Development Council |

Governance principles and the main duties of the Board, under the leadership of the chairperson, executive and non-executive directors, including the Group Chief Executive Officer (GCEO) and Group Chief Financial Officer (GCFO), are clearly

documented in the Board Charter.

Denel's Board Charter includes a schedule of matters reserved for the Board and the terms of reference of the respective board committees. The governance framework was developed to meet the group's strategic objectives and compliance requirements.

## PART 6 OUR GOVERNANCE

At the same time, it balances the interests of stakeholders, and minimises and avoids conflicts of interest, while practicing good corporate behaviour. The Board further delegated management accountability to the company's GCEO through the Delegation of Authority Policy and performance contract.

As a state-owned company, the company enters into an annual Shareholder's Compact with the Government of South Africa, represented by the Minister of Public Enterprises. This contract sets out annual key

performance company deliverables that cover, but are not limited to social and economic drivers.

Although each of the group's subsidiary companies has a separate board of directors, the Denel Board and its committees oversee all significant aspects and transactions of the subsidiaries. The subsidiaries are also governed by the limits of authority set by the Board in the Delegation of Authority.

The Board plays a critical role in strategic planning and establishes clear benchmarks to measure the company's performance. Sound corporate governance practices underlie Denel's values, culture and processes. The group is managed in an efficient, accountable, transparent and ethical manner. This ethos is

embedded in all the group's activities and, thus, Denel's governance framework goes beyond mere compliance with legislation.

### RESPONSIBILITY AND ACCOUNTABILITY

The Denel Board provides leadership and strategic oversight, and specifically oversees the internal control environment to sustain value for the company's shareholder and stakeholders. The Board ensures adherence to principles of good governance and accountability as espoused in its Board Charter and the King IV report. All the members of the Board are individually and collectively aware of their responsibilities to the group's stakeholders and each director brings experience, independence and judgment.

### COMPOSITION OF THE BOARD

The Denel group has a unitary Board, comprising two *ex-officio* directors, the GCEO and the GCFO, as well as twelve independent non-executive directors. The company supports the principles of gender diversity at Board level. Collectively, the Board believes the current mix of knowledge, skill and experience meets the requirements to lead the company effectively.



BOARD BY  
GENDER

FEMALE MALE

BOARD BY  
AGE

30-45 (23%) 46-50 (46%) 51-60 (8%) ABOVE (38%)

### APPOINTMENT AND RETIREMENT OF DIRECTORS

In terms of Denel's Memorandum of Incorporation (MOI), the Shareholder appoints the chairperson, GCEO and non-executive directors. The remaining *ex-officio* director (the GCFO) is appointed by the Board with the approval of the Shareholder.

Denel's Shareholder reviews the composition of the Board on an annual basis to ensure the rotation of directors at appropriate intervals and for the Board to remain dynamic in its thinking and abilities. The term of office for the non executive directors is a period of three years subject to annual review and confirmation by the Shareholder at the Annual General Meeting (AGM). While retiring non executive directors are eligible for re-appointment, director retirement is staggered to ensure



continuity. The *ex-officio* directors are appointed on fixed-term contracts. been removed during the year: comprise the GCEO and GCFO, who The following directors have resigned or

- Previous CFO

### FORMALISATION OF DIRECTOR APPOINTMENTS AND REMUNERATION

Denel's executives have contracts of employment with the company that are subject to Denel's conditions of service. Non-executive directors have their appointments formalised through a letter of appointment from the Shareholder. The appointment letters indicate the terms of office of the non executive directors, legislation governing their appointment, as well as information pertaining to their remuneration.

The following directors were appointed during the year:

- Carmen Le Grange

### DIRECTORIAL INDEPENDENCE, EFFECTIVENESS AND PERFORMANCE EVALUATION

It is incumbent upon the Board to act in the best interest of the company at all times, as guided by the King IV report, the Companies Act and best practice. Accordingly, the independence of individual non-executive directors is considered at every Board meeting and evaluated annually as part of the Board's effectiveness review. This process creates value for the group and its stakeholders and ensures greater accountability. To ensure that governance best practice is applied, the Company Secretary performed a Board effectiveness review subsequent to the financial year end. The following areas were identified for improvement:

- Additional skills set in engineering, the defence industry, commercial, risk management, IT and accounting (preferably a Chartered Accountant) should be present at board level
- Setting an appropriate executive remuneration philosophy/policy linked to the key drivers of the business
- Implementing adequate succession plans for key members of the executive team
- Monitoring IT governance in the company, either itself or through a committee



- Information is to be presented in a way that leads to useful discussions and informed decisions at Board level
- Strategy implementation, strengthening of the capital structure and improving financial performance

### MANAGING CONFLICT OF INTEREST

The principle of the effective management of conflicts of interest is paramount to limit risk and ensure transparency. Denel's Board members declare their interests at each Board and Board Committee meeting regarding any agenda item to prevent a director's personal interests taking precedence over those of the company. Directors' interests are declared by the individual directors in a register that is presented to Denel's shareholder at every AGM for consideration. Moreover, the conflict of interest schedule has been enhanced significantly. Directors who have personal interests in a matter under discussion disclose their interests and recuse themselves from the meeting.



For the period under assessment, no such conflict of interest was declared by Denel's directors regarding agenda items tabled at either the Board or Board Committee meetings. A similar practice applies to all employees of the group.

### BOARD INDUCTION AND SHARING OF INFORMATION

Given that Denel operates in a highly technical environment, a comprehensive induction for new directors assists them in acquiring a greater understanding of Denel's business operations, its range of products and services, as well as the way these integrate into defence systems. The Board needs to appreciate the specific legislative framework applicable to the group as a defence manufacturer, as well as the business risks, governance processes and delegation of authority. Directors are continuously briefed on relevant new legislation and regulations. This year, the Board was updated on the principles of the King IV report on corporate governance by Adv Annemarie van der Merwe, a member of the King Committee. The Board Charter and terms of reference of Board

committees were reviewed and revised to align them with the principles of King IV and subsequent changes in the functions of some of the Board committees, and approved by the Board. Directors attended several defence exhibitions to further their knowledge of the defence industry.

The directors met with the different business unit executives. Quarterly reports were circulated to

directors for their approval to keep them abreast of developments during and outside of scheduled Board meetings. Attendance at some of the defence exhibitions in which Denel participates allows directors to have a first-hand experience of the global defence market, where the group's products and services compete with the best on offer.

## PART 6 OUR GOVERNANCE

### GROUP COMPANY SECRETARY

The Group Company Secretary is responsible for developing systems and processes to enable the Board to discharge its specific functions. This ensures significantly enhanced organisational efficiency. This function has the effect of limiting risk and improving accountability. The Group Company Secretary also advises the

Board on corporate governance issues, sets the annual plan for the Board in conjunction with the Chairperson and monitors compliance with relevant legislation, including the PFMA, National Treasury Regulations and the Companies Act. All directors have access to the incumbent for company relevant services and guidance and the Group Company Secretary also keeps the Board updated on any new relevant legislation.

### BOARD MEETINGS

Meetings of the Board are convened by formal notice as per the annual schedule. The schedule is compiled by the Group Company Secretary and approved by the Board. Special meetings are convened as and when required to address specific material issues. Corporate governance, especially transparency and accountability, is enhanced with comprehensively compiled Board documents submitted by the executive management.

### KEY ISSUES CONSIDERED AND APPROVED/NOTED BY THE BOARD THIS YEAR:

	MATERIAL MATTERS CONSIDERED
Board	<p>During the 2019/20 financial year, the Board fulfilled the following duties in accordance with its mandate:</p> <ul style="list-style-type: none"> <li>• Reviewed and approved the strategy and strategic objectives of Denel</li> <li>• Approved the 2019 Integrated Report, including the annual financial statements</li> <li>• Approved reports to the Shareholder, including the quarterly business reports</li> <li>• Set the tone of the company values, including principles of ethical business practice and the requirements of being a responsible corporate citizen</li> <li>• Confirmed that the company complies with all applicable laws and best corporate governance practices</li> <li>• Exercised independent, informed and effective judgment to bear on material decisions of the group's companies</li> <li>• Reviewed management's assertion on its liquidity and going concern basis</li> <li>• Assessed the stability of the executive management</li> <li>• Issued a statement on performance management</li> </ul>

## DETAILS REGARDING BOARD MEETING ATTENDANCE ARE REFLECTED BELOW:

BOARD MEMBER												
Ms MW Hlahla (Chairperson)	11/11	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	T
Ms M K Lehloanya <sup>1</sup>	10/11	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	A
Mr TH Magazi	10/11	✓	✓	✓	✓	A	✓	✓	✓	✓	✓	✓
Lt Gen TT Matanzima	10/11	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	A
Mr MM Mnisi	7/11	✓	✓	✓	T	A	✓	✓	A	A	✓	A
Dr H Nel	10/11	✓	✓	A	✓	✓	✓	✓	✓	✓	✓	T
Gen S Nyanda (retired)	10/11	✓	A	✓	✓	✓	✓	✓	✓	✓	✓	T
Ms SR Rabkin	11/11	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	T
Mr MT Sadik	9/11	✓	T	✓	✓	✓	✓	A	✓	A	✓	T
Mrs GT Serobe	9/11	✓	✓	A	✓	✓	✓	A	✓	✓	✓	T
Dr SP Sibisi	6/11	✓	A	✓	A	A	✓	A	A	✓	✓	T
Ms N Siyotula	7/11	T	T	✓	✓	✓	A	A	A	T	A	T
Mr D du Toit	11/11	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mr W de Klerk <sup>1</sup>	1/1	✓	-	-	-	-	-	-	-	-	-	-
Mr G P van Zyl <sup>2</sup>	2/2	-	✓	✓	-	-	-	-	-	-	-	-
Ms C Le Grange <sup>3</sup>	7/8				✓	✓	A	✓	✓	✓	✓	✓

A = Apology  
T = Via telecon  
<sup>1</sup> = Resigned on 14 June 2019  
<sup>2</sup> = Acting GCFO from 1 June 2019 to 30 August 2019  
<sup>3</sup> = Appointed GCFO from 1 September 2019

# PART 6

## OUR GOVERNANCE

### BOARD COMMITTEES

The Board delegates specific

responsibilities to five standing Board committees, namely the Audit Committee, the Risk Committee, the Personnel, Remuneration and Transformation (PR&T) Committee, the Social and Ethics (S&E) Committee

DENEL GROUP INTEGRATED REPORT 2019/2020 79

and the Finance and Investment Committee. The Board committees assist the directors to discharge their duties and ensure the Board's effectiveness in discharging its duties. The committees' terms of reference and the Board Charter are reviewed

annually to limit risk and ensure that they remain in line with relevant regulations, company requirements and best practice in corporate governance.

The Audit Committee meets four times a year, in agreement with the company's Memorandum of Incorporation, and the other Board committees meet a minimum three times a year. Executives regularly attend the Board Committee meetings in line with their roles and responsibilities.

The respective Chairperson's reports form an integral part to keep the Board abreast of the Board committees' activities. Significant matters discussed at these Board Committee meetings are regularly submitted with recommendations for the Board to deliberate and decide.

### AUDIT COMMITTEE

The Audit Committee, including its Chairperson, comprises only independent non-executive directors, with the executive directors as standing

invitees to the committee meetings. Members of the Audit Committee have considerable expertise in various fields, notably risk management and the commercial and legal experience necessary to oversee and guide the Board.



The Audit Committee provides the following support to the group: the external and internal

audit functions, corporate governance and the governance of information technology. To improve accountability and limit risk, the appointment of members of the Audit Committee is reconsidered and voted on at every AGM.

The Audit Committee's terms of reference are reviewed and updated annually in line with relevant legislation and best practice. The terms of reference include the Committee's mandate, which is to ensure the

integrity of financial reporting, the adequacy of governance and the soundness of the internal control environment.

The Audit Committee provides the following support activities to the Board of Directors:

- Reviews the Integrated Report, including consolidated annual financial statements, and consider reports of the auditors on the financial statements
- Reviews the effectiveness of the company's internal controls
- Considers matters emanating from the company's ethics hotline, planned management actions and the results of enquiries in conjunction with the S&E Committee
- Agrees on the scope of the auditors' work and their fees
- Monitors the performance of the internal audit function
- Considers the combined assurance model, assessing levels of assurance that is provided by auditors, regulators, management and other assurance providers
- IT governance

### KEY ISSUES CONSIDERED AND RECOMMENDED TO THE BOARD/NOTED BY THE AUDIT COMMITTEE THIS YEAR:

	MATERIAL MATTERS CONSIDERED
Audit Committee	<p>During the 2019/20 financial year, the Committee, among other things, focused on the following:</p> <ul style="list-style-type: none"> <li>• Reviewed and recommended for adoption to the Board the Annual Financial Statements and the Integrated Report for 2019</li> <li>• Reviewed the reports from the internal and external auditors regarding the effectiveness of the internal control environment</li> <li>• Monitored the appropriateness of the company's combined assurance model</li> <li>• Approved the external audit plans</li> <li>• Reviewed and recommended the external audit fees</li> <li>• Reviewed the quality and effectiveness of the external audit process</li> <li>• Reviewed the quarterly reports before submission to the executive and accounting authorities</li> <li>• Led investigations sanctioned by the State Capture Commission</li> </ul>