



DENEL BUSINESS UPDATE

Presentation to Joint
Portfolio Committee
and Select Committee



31 August 2022





INDEX

1. Denel Current State
2. Sustainability
3. Next steps
4. Governance



1. Denel Current State

DENEL “AS IS”

Challenges

- **Denel has accumulated R3.3 bn in legacy debt** including circa R966m to supplier;
- Denel is **unable to raise the necessary trading facilities** (bank guarantees and performance bonds) that are critical to conclude new projects and that the defence sector is unique and highly drive by Geopolitics.
- In August 2021, **Fitch Ratings downgraded Denel’s** investment status because of the negative equity and **absence of a plan by the shareholder** to improve the balance sheet;
- **Uncertainty on Denel’s future state has impacted the current customers** who are concerned about Denel’s ability to deliver on contracts **leading to a possible call on prepayments and performance** guarantees (circa R3,4bn);
- **Restructuring cost of circa R577m and working capital of approximately R400 million** is required to execute the work on hand and **return the company to profitability**;

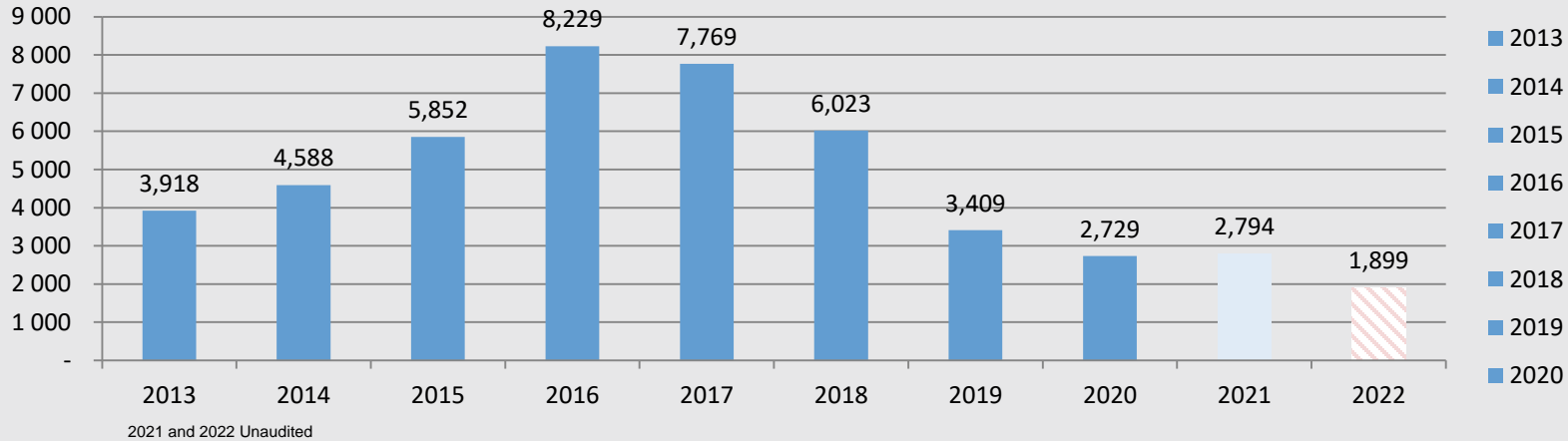
Positives

- The **Minister of Finance has agreed to settle R2.9 billion of Denel’s guaranteed debt. However, this does not resolve Denel’s immediate liquidity requirements** to restart operations and to settle legacy obligations that are impacting viability;
- Business units and **programmes were ringfenced** and despite the extreme difficulties **continued to deliver key services and products** with support from clients and suppliers where feasible;
- **The embedded institutional knowledge in the defence assisted in rebuilding Denel Brand and continues to attract interest with approaches from the international market and local industry** for its **products and skills** with significant **opportunities in the pipeline** if the financial position can be resolved;
- Denel has **paid all outstanding salaries to employees** from the funds raised from the Denel Medical Benefit Trust;
- There is **large appetite for strategic partnerships** in the **client environment and private sector** that can be leveraged to sustain sovereign and strategic capabilities and return Denel to financial sustainability; and
- **The Principals have firmly articulated that Denel is a sovereign and strategic capability and must be supported in the National interest.**



RESULTS

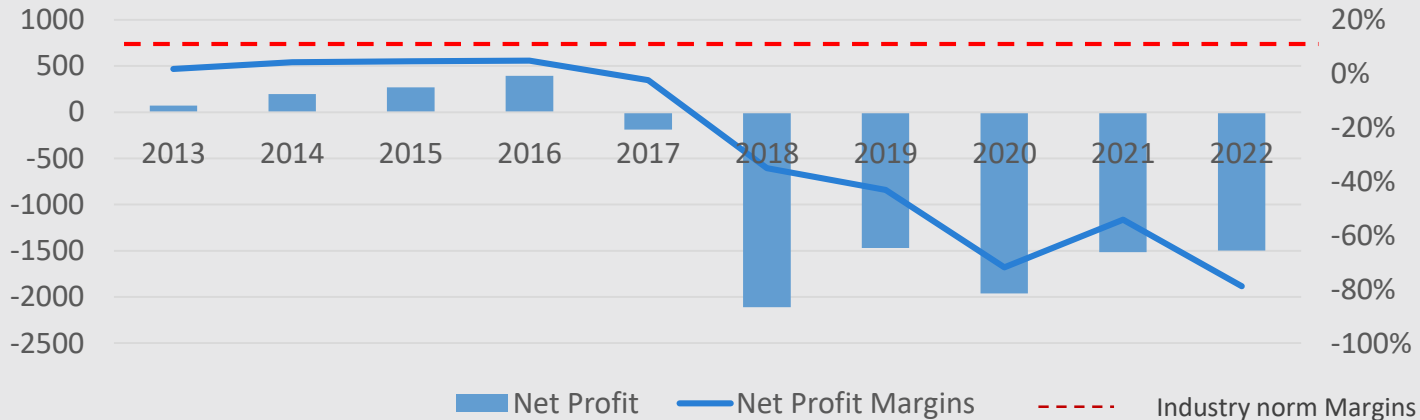
Revenue



- Reduction in revenue over the years and at low levels of R1,8bn in FY2022 (77% reduction since FY2016);
- Affected by inability to execute on existing work due to liquidity constrains;
- Contracting and export permits related issues with NCACC; and inability to secure guarantees for new business.

RESULTS

NET PROFIT

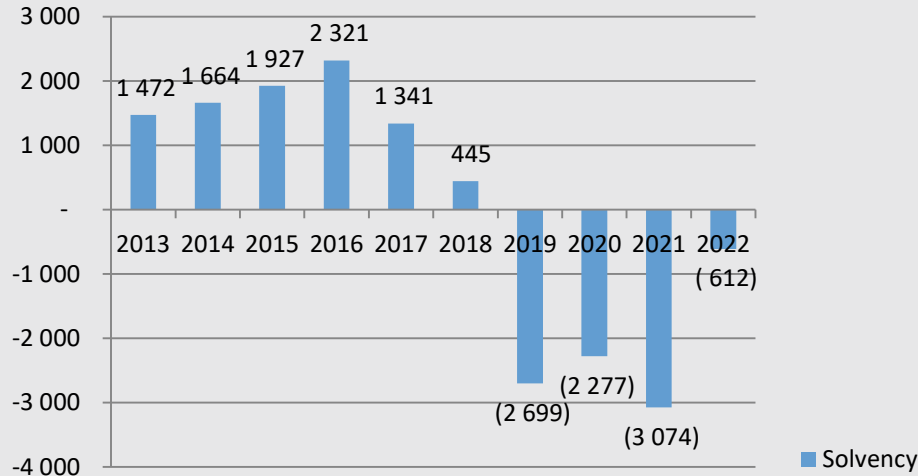


2021 and 2022 Unaudited

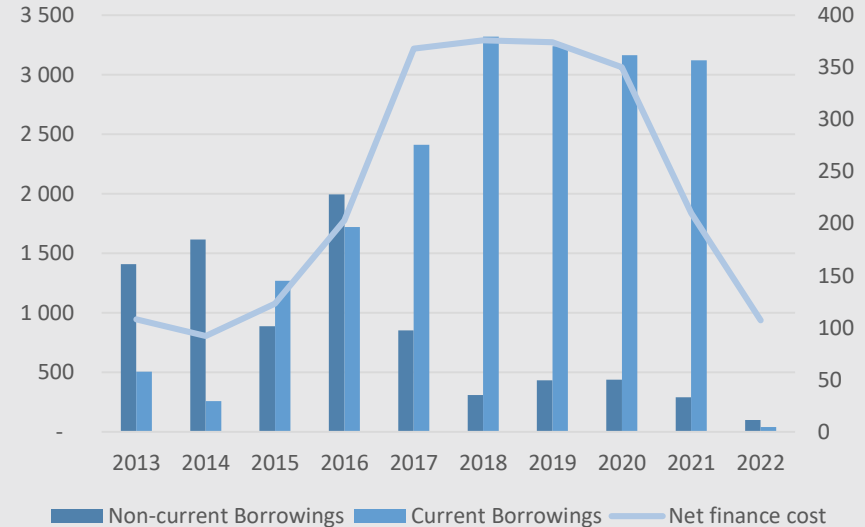
- Plummeting revenue levels;
- Margins far lower than industry norm of between 7% - 10%
- High cost structure including labour under-recoveries; and
- High levels of debt leading to high interest expense;

RESULTS

Solvency



Debt and net finance costs



- Technically insolvent since 2019;
- Unsustainable high current borrowings since 2017 leading to high finance cost;
- Debt reduced by the guaranteed debt stepping-in clause allowing the Shareholder's assistance in the redemption of bonds in FY2022;



2. SUSTAINABILITY

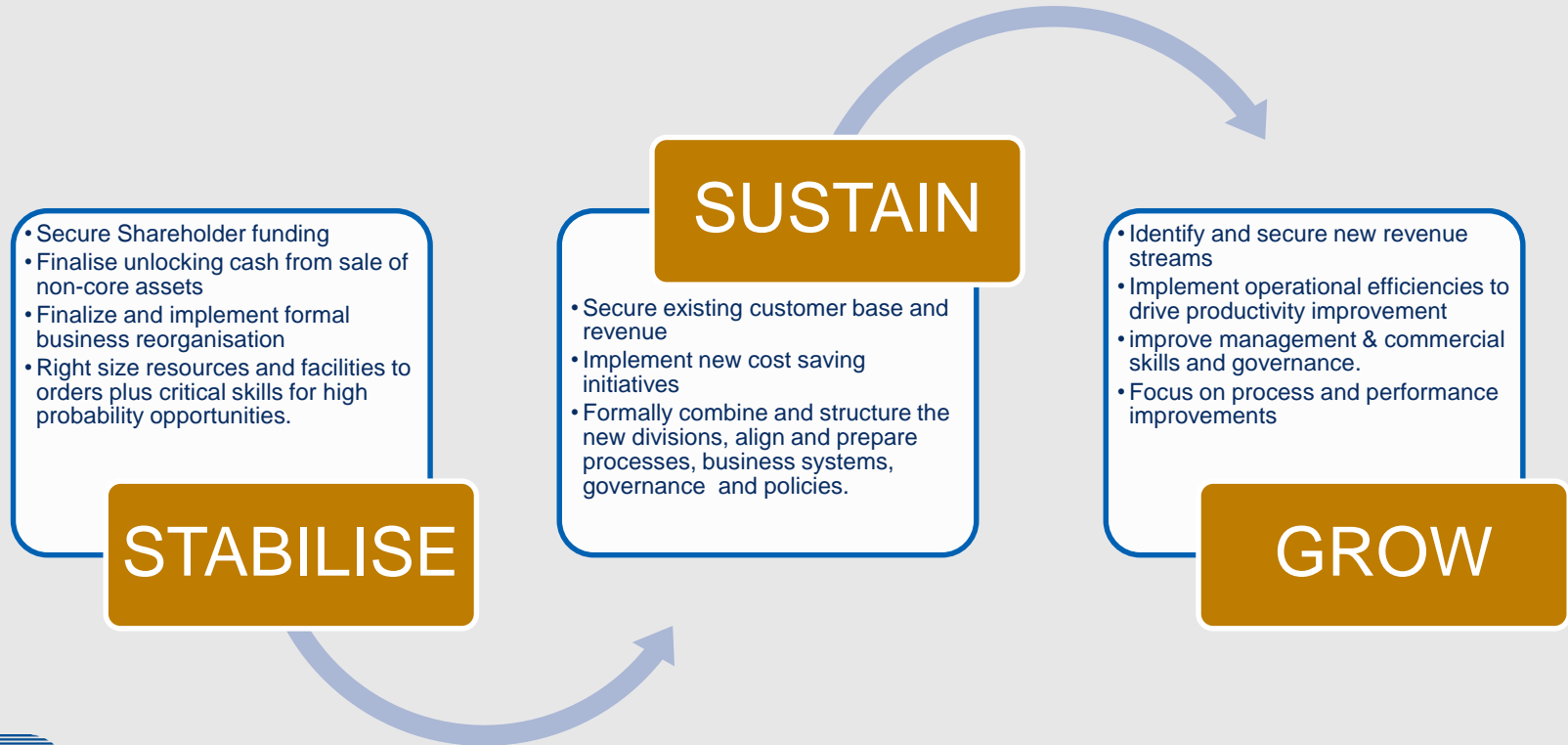
CASE TO REBUILD DENEL

- A **critical success factor to Denel is the existing order pipeline and the additional order pipeline**, that **underpin and support the viable turn-around of Denel. Denel can be self-sustaining** with:
 - a confirmed order book of circa R12 billion total over the next business plan cycle,
 - high probability (> 50%) opportunities of circa R8bn on Denel's horizon with the local and other established clients:
 - the **Geo-Political instability in Europe and other parts of the world** is going to give impetus for significant Defence industrial requirements. If Denel is returned to a sound footing, this **should be exploited and will yield many opportunities for Denel**. Furthermore, once interventions have been implemented to undo the reputational damage and Denel is on a positive trajectory, an improvement to the probability of the above opportunities will be realised and **Denel can expect an order pipeline of at least R30bn over the next 5 years**.
- There is still **significant interest in Denel's battle proven intellectual property (IP)**. Despite its financial difficulties, there is still appetite by numerous countries and companies to acquire Denel's products or form deeper strategic relationships
- **Denel should be able to restore Critical Capabilities** by either attracting skill sets directly or through support of the local industry.
- **The broader local supply chain can still support Denel** - many local companies with international accreditations that have been developed over many years, and eager to be part of Denel's growth.
- Some of **Denel's core capabilities can be offered outside of the traditional defence sector** in diverse sections of the commercial economy as well as to other state owned entities.
- **Deep restructuring** for efficiency, to eliminate duplications and improve operations are part of the restructuring plan to return the organisation to financial stability.
- A fully **funded plan** to pay **legacy debt** and provide **working capital** to execute the current programmes **will definitely bring the business to financial stability**.

CASE TO REBUILD DENEL....Continue

- Denel has developed a **credible business plan** based on a comprehensive turnaround and strategic restructuring intervention under the leadership of **an appointed Chief Restructuring Officer**, approved by its **Board and Shareholder** and submitted to National Treasury for consideration for **recapitalisation** in the MTEF process.
- On 2 July 2022, the **Minister of Finance urged** that Denel fast track the non-core disposals, the alignment of Denel's Stakeholders and **the implementation of Denel's turn-around plan**, as reiterated by the Minister of Public Enterprises in his letter to Denel Board dated 27 July 2022.
- The plan is based on **raising own funding of R1.8bn** through the sale of non-core assets and **remainder through a recapitalisation by the Government.**
- **Good progress** has been made on the **disposal of non core assets**. The funds received of (R992m) from the Denel Medical Benefit Trust has been instrumental to provide some stability and the restarting of operations with the payment of backlog salaries, institution of a payment plan for SARS and payment of creditors threatening liquidation actions, and allocation to critical working capital. Realisation of a further R400m from the disposal of non-core assets is highly probable before the MTEF budget announcement in February 2023. However, **funding for available working capital and payment plans will run out by Oct 2022 if interim relief is not secured and operations will be stalled and Denel will be severely exposed once again.** The company will simultaneously continue to raise internal funding in support of this request through the sale of non-core assets.

DENEL'S STRATEGIC APPROACH IN RESPONSE TO THE CURRENT AND FUTURE MARKET OUTLOOK





3. NEXT STEPS

KEY INTERVENTIONS

In order to achieve sustainability and unlock the order pipeline for growth, significant changes are required to support the strategic intent to secure a new credible Denel for the future.

Denel requires the following immediate interventions:

- **Effective stakeholder management** to initiate a repositioning strategy to ensure that the Denel Brand continues to enjoy the support of the Market; concerted effort to be given to business development to market our products
- To be unshackled from legacy debt;
- **Restructure** for efficiency;
- **Reduce cost base** – overheads, foot-print, head count, etc;
- Implement **streamlined and effective policies and processes** (including engineering, manufacturing, contracting and project execution processes, supply chain management, skills development and retention, etc);
- Develop access to **new revenue streams**; and
- Enforce **effective management and executive leadership capabilities to lead the restructuring interventions.**



SUSTAINABILITY OF DENEL & INDUSTRY

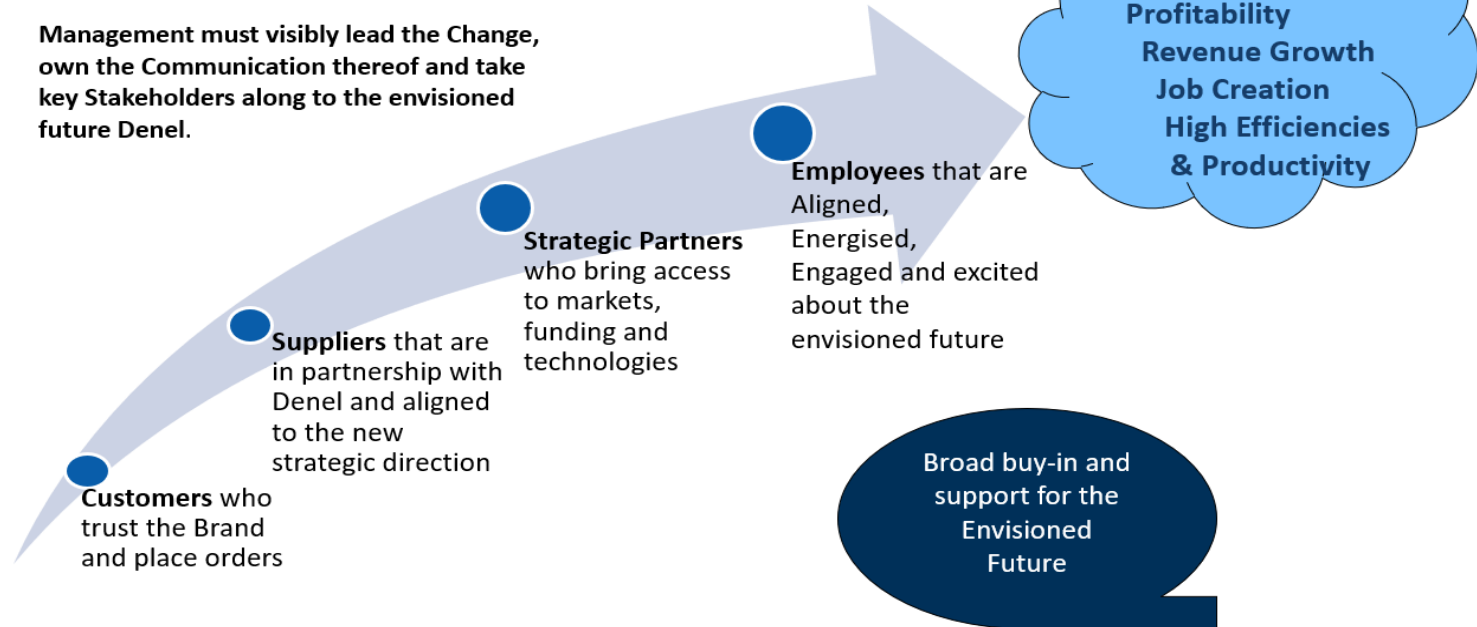
- The **strategic Intent is to reduce dependence on the fiscus** for the maintenance of critical strategic and sovereign capabilities
- The recapitalisation will set the organisation on a **solid basis** as the restructuring will **right size the organisation to current revenue levels. Exports increase economies of scale which will further support the funding of strategic and sovereign capabilities.** These will be **managed through ring-fencing and flexible resourcing** to minimise the impact of rapid declines in exports like cliff face that as experienced during Covid Pandemic. Furthermore, in-country capabilities will minimise the cost of securing and maintaining strategic capabilities.
- **Alignment with DoD and Armscor on identified sovereign and strategic capabilities** and the funding thereof to be identified and articulated through a formalised tripartite Memorandum of Co-operation between the DoD (SANDF), Armscor and the DPE (Denel).
- **Denel will employ smart partnerships with industry and create the majority of these jobs in industry** and not within Denel and to ensure that **Denel remains lean and mean with flexible cost structure and that capabilities can be leveraged for other productive endeavours** in private industry.
- **Job Retention / Creation** – the planned growth path will result in direct high quality jobs in Industry of **approximately 1000 people (with a multiplier of 4:1 for indirect jobs of 4000) in the next 3 years. Targeting 5000 direct (and indirect 20000 on multiplier effect)** with a return to 2017 revenue levels in 5 years.
- **Once Denel has been stabilised** and reputational damage restored, **the organisation will employ a strategy of credible long-term strategic partnerships in all its businesses to entrench our position in the local and international market that is aligned to national interests and maximise the value of the Intellectual property and capabilities within Denel**



TAKING DENEL FORWARD

Redefine Denel, then:

Management must visibly lead the Change, own the Communication thereof and take key Stakeholders along to the envisioned future Denel.





4. GOVERNANCE

GOVERNANCE

- The Zondo Commission's State Capture Report in respect of Denel makes the following Key Findings and Recommendations:
 - **Failure of good Corporate Governance**
 - **Abuse of power by the Board of Directors**
 - **Improper practice by the Chairperson of the Board, Mr. Mantsha**
 - **Establishment of a body that focuses on recruitment and selection of right people to be considered for appointment as Board members, Chief Executive and Chief Financial Officers**
 - **Referral of Mr Mantsha to the Law Practices Council for investigation into his fitness to practice as an attorney**
 - **Board of Directors to be subjected to Delinquent Proceedings in terms of the Companies Act.**
- SIU Investigations in terms of Denel Proclamations



IMPLEMENTATION OF STATE CAPTURE RECOMMENDATIONS

SOE	Source Report	Allegation/transgression/value	Parties implicated	Commission recommendation	implementation status
Denel	State Capture Commission of Inquiry	Board failed to carry out its fiduciary duties	Board of directors	Establishment of a body that focuses on recruitment and selection of right people to be considered for appointment as Board members, Chief executive and Chief financial officers.	DPE to establish this body to focus on recruitment
Denel	State Capture Commission of Inquiry	Possible contravention of PFMA in dealings with the VR Laser Hulls contract, suspension and settlement payments of three executives	Board of Directors	Law enforcement agencies to investigate irregular awarding of VR laser contract.	SIU has completed the Investigation and finalising criminal referrals
Denel	State Capture Commission of Inquiry	The Board be referred to law enforcement for investigation and possible prosecution for contravention of PFMA	Board of directors	Law enforcement agencies to conduct further investigation in contravention of PFMA for suspension of executives	SIU has consulted to assist in the investigation
Denel	State Capture Commission of Inquiry	Board be subjected to Director delinquency application for breach of Section 162 of the Companies Act	Board of directors	Board to be declared delinquent.	In consultation with Senior Counsel, it is suggested that a class action be brought in the constitutional court. Denel will work with Senior counsel appointed by DPE to make the application

SIU INVESTIGATIONS IN TEMRS OF DENEL PROCLAMATIONS

- Current/ On-going SIU Investigations:
 - Formation of Denel Asia
 - VR Laser's Single Source Contract
 - Suspension of Executives by the board headed by Mr Mantsha
 - Interventions of Denel affairs by Mr. Salim Essa, the Gupta family and their proxies
 - Awarding of pilot bursaries
 - Chad Contract

SIU INVESTIGATIONS

SOE	Source Report	Allegation/transgression/value	Parties implicated	Findings	implementation status
Denel	SIU report	<ul style="list-style-type: none"> Telspace would render to Denel services described as “security Assessment – Red Team Penetration Testing’ Value – R6 628 400 	Telspace	<ul style="list-style-type: none"> Procurement processes not followed 	<ul style="list-style-type: none"> SIU finalising court papers
Denel	SIU report	<ul style="list-style-type: none"> VR Laser was appointed as the single-source supplier to Denel Land Systems (‘DLS’) for the provision of all fabricated steel services and goods, such as fabricated structures and hulls. Value – R276m 	VR Laser, Denel Land Systems, Denel Corporate Office	<ul style="list-style-type: none"> Contracted awarded irregularly 	<ul style="list-style-type: none"> SIU has submitted report on findings to legal in preparation for referring matters and drafting of memos
Denel	SIU report	<ul style="list-style-type: none"> Irregular awarding of bursaries to three individuals for their studies at Air School for the sums of R801 927.30, R793 308.90 and R1 156 378.20. 	Denel Corporate Office, Air School and the students	<ul style="list-style-type: none"> Denel Policy not followed 	<ul style="list-style-type: none"> Case No: 12665/19 SIU continuing with claim against Air School and the two students Settlement reached for the repayment of R 559 990.65 in respect of one student Possible recovery from 43 Air School
Denel	SIU report	<ul style="list-style-type: none"> Purchase of Vehicle Irregular appointment of ENN7 Irregular appointment of TA Value – R 270m 	Chad	<ul style="list-style-type: none"> Maladministration 	<ul style="list-style-type: none"> SIU proceeding with investigation

SIU INVESTIGATIONS

SOE	Source Report	Allegation/transgression/value	Parties implicated	Findings	implementation status
Denel	SIU report	<ul style="list-style-type: none"> Alleged procurement processes was not followed to appoint attorneys that was not on the database Value - R10m 	Khampa Attorneys	<ul style="list-style-type: none"> Procurement processes not followed 	<ul style="list-style-type: none"> 12665/19 Court matter NPA referral
Denel	SIU report	<ul style="list-style-type: none"> Unlawful irregular or unapproved measures or practices in relation to the misappropriation of proprietary and intellectual property rights in Denel's Air-to Air missiles, Stand-off Weapons, Surface Target Missiles, Air Defence and Unmanned Aerial Vehicle systems Value R 376m (P2 P3) – Value of IP Stolen in Denel Dynamics – R 5bn 	Denel Dynamics/ Tawazun Dynamics/ EDIC	<ul style="list-style-type: none"> IP was misappropriated in cohesive criminal conduct to abet foreign state companies 	<ul style="list-style-type: none"> NPA referral for Civil case NPA referral documents provided by SIU
Denel	SIU report	<ul style="list-style-type: none"> Investigation completed and a closure memorandum filed with the office of the PMO Value R600m 	The procurement of advance payment bank guarantees	<ul style="list-style-type: none"> Procurement process not followed 	<ul style="list-style-type: none"> Investigation completed and a closure memorandum filed with the office of the PMO

