Report of the Portfolio Committee on Public Enterprises on the oversight visit to Eskom, South African Airways, South African Express Airways and Denel, dated 30 September 2022

1. Introduction

The Portfolio Committee on Public Enterprises (the Committee) undertook an oversight visit to Cape Town and Gauteng. The Committee visited Koeberg power station, liquidators of South African Express Airways, South African Airways and Denel from 19-22 April 2022.

1.1 Background

State-owned enterprises are under serious operational, governance and financial distress, while some are facing liquidity challenges. This has led to some entities applying for business rescue as in the case of Mango and entities such as South African Express Airways filling for liquidation. The Committee undertook an oversight to these companies in order to appraise itself and engage with the leadership of SOCs on progress being made to address the financial challenges facing these companies. These challenges include, amongst others:

1.1.1 Denel has been unable to pay salaries of employees and have not been getting business orders. Furthermore, the company could not submit financial statements and the annual report for the 2021/22 financial year to Parliament.

1.1.2 South African Express Airways is in the process of liquidation and the liquidators had not yet appraised the Committee on the progress of the liquidation process.

1.1.3 South African Airways has recently concluded an equity partnership agreement and resumed operations. The Committee would like to familiarise itself with how this new arrangement works, including the performance of the new business model.

1.1.4 The Committee received a complaint from the National Union of Mineworkers regarding contract management irregularities that can cost Eskom more than a R1 billion in wasteful expenditure. This contract relates to the replacement of the steam generator.

1.2 Delegation

The Committee delegation included the following members: Mr K Magaxa (Chairperson of the Committee, ANC), Ms J Tshabalala (ANC), Ms J Mkhwanazi (ANC), Mr G Cachalia (DA) and Ms R Komane (EFF). The delegation was accompanied by the following parliamentary officials: Mr D Mocumi (Committee Secretary), Ms Y Cele (Committee Assistant), Ms L Bramwell (Researcher) and Mr R Mnisi (Content Advisor).

2. Visit to Koeberg power station

The Portfolio Committee on Public Enterprises undertook an oversight visit to the Koeberg Nuclear Power Station, which is the only nuclear power plant on the African continent. The purpose of the oversight visit was to see the activities of the power plant, get an update on the current status of the national power grid and a briefing by the National Union of Mineworkers (NUM) on allegations of irregularities. This was undertaken on the 19th of April 2022. The oversight visit was held jointly with the Portfolio Committee on Mineral Resources and Energy.

2.1 Introductory remarks of GCEO, Mr Andre De Ruyter

The Committees were received by the Eskom delegation at the Power station situated in Melkbosstrand in the Western Cape. The Committee was welcomed by the Chief Executive Officer (CEO), Mr. Andre De Ruyter, via a virtual link. In welcoming the Committee to the Power Plant, the CEO made the following remarks.

2.1.1 Loadshedding

Stage 4 loadshedding had been implemented on 19 April 2022 due to unit trips with unplanned load losses amounting to 15 690 MW. The crisis was not new but South Africa has had 15 years of load shedding which was still unresolved. The origins started with the 1998 White paper that required new capacity to be added, however, a decision was taken in 2002 not to undertake any new builds of generation units. This resulted in the existing plants being run harder and harder with less maintenance. For only three years, 2016, 2017, 2021, planned maintenance exceeded 10 per cent, where the bench mark is 18 per cent or at least 13 per cent.

2.1.2 Maintenance

Currently, the utility does not have enough capacity to implement planned maintenance. This situation was compounded by the last Independent Power Producer (IPP) contract being concluded in 2014. Eskom also played a role in not contracting IPPs. The move by Eskom to short-term coal procurement processes in 2015 also added to the crisis. The short-term suppliers caused additional failures due to poor coal quality. Damage to Kendal and Medupi in 2018 and 2021 respectively also reduced available capacity, while Koeberg unit 2 is on outage for refuelling. The challenge of wet coal also affects plant reliability.

2.1.3 Mitigating interventions

The GCEO stated that the following could be done to add more capacity to the grid and help alleviate load shedding:

- Policy decisions, by amending contracts by the IPP office, could access 200MW from existing IPPs,
- 200MW available by removing bottlenecks,
- Additional 200MW available by upgrading infrastructure,
- The National Energy Regulator of South Africa (NERSA) should simplify registration process for installations 100MW and under, as allowed by the new legislation.

Furthermore, the following can be done to increase capacity:

- Accelerate Environmental Impact Assessment (EIA) process;
- Accelerate the creation of the Market Operator;

Further, Eskom is also extending the life of the Koeberg nuclear power plants for another 20 years. Eskom has requested approval from NERSA, however the utility is still awaiting approval.

2.1.4 Financial sustainability

The utility's liquidity constraints can be alleviated if the municipal debt amounting to R47 billion can be paid to Eskom. Eskom needs cash flow to manage its maintenance programme which is the cornerstone of Eskom's capacity constraints.

2.2 Submission by National Union of Mineworkers: Mr P Mvovo

A shopsteward of NUM, Mr Mvovo at the Koeberg power Station made the following presentation to the Committees on the steam generator replacement (SGR) programme being undertaken by the utility.

2.2.1 The current steam generators have primary and secondary leaks and tube degradation. In their view, the deferment of the SGR of unit 2 to August 2023 should not be allowed. The contractor for the SGR was appointed in suspicious circumstances, the contractor, Framatome, was the only one who could meet the timeframe. The three Unit 1 steam generators are due for replacement in October 2022, however, there is not one SG on site at the moment, thus there are fears that time frames for the SGR programme for Unit 1 might be delayed as well.

2.2.2 The Chief Operating Officer (COO), Mr. Obenholzer, took the project away from the Koeberg team to Rotek, then gave it to ERI project management and Wilson Baily Holmes (WBHO). The project was close to completion. The Outage for Unit 2 started on 17 January 2022. The outage was going well, when the contractor suddenly saw problems.

2.2.3 The CEO of Framatome came to site but had no interest in fixing the challenges. The SGR team was then told that the project would be two months late. This was already 55 days into the 155-day outage of the unit. The union objects to why the contractor is dictating terms to Eskom. The union submitted a grievance to management regarding this, it has not been resolved to date.

2.2.4 The union stated that the COO and the Chief Nuclear Officer (CNO) had a meeting with the Framatome CEO, while the SGR team was the last to learn of this meeting. Management put pressure on Eskom to pay Framatome, but the employees did not agree to the payment of the company. Eskom was blamed for deferral of the project when in fact it was not Eskom but Framatome who was responsible for the deferment. The union called for an in-depth investigation into this matter.

2.3 Eskom's response to the NUM presentation

In response to the NUM presentation, Eskom agreed that they were losing skilled staff, especially nuclear operators. Due to Eskom's financial position, Eskom was unable to offer increases, bonuses, etc. to retain staff, leading to staff taking job opportunities abroad. However, Eskom assured the Committee they were not taking any undue risks at the nuclear power plant. The SGR outages were being operated safely and Koeberg never lacked maintenance over the years. The CEO stated that the entity was not being reckless and that the deferment of the SGR for Unit 2 would not lead to job losses.

The delay of two and a half years was not all the fault of Framatome but could also be placed on Eskom to some extent. The grievances brought by the internal SGR team was in the process of being addressed.

With regards to safety, the Nuclear Safety Officer assured the Committee that all due processes were followed internally. He stated that there was no plan with the contractors with regards to time and milestones reached, they needed a clear plan.
Based on the outage at that stage, the contractors estimated a late return to service for the unit. A late start-up would impact on the next unit outage. The late outage would be anywhere between July and November 2022. This would impact on the preparation of unit 1 outage. As the late outage would impact on the SGR project for Unit 1, it was decided to remove the SGR from the current outage. The current outage would then see the replacement of valves and safety upgrades.

2.4 Site visit to the Koeberg plant

The Committee undertook a site visit to the plant to view the steam generators. During the viewing, the Committee was interested in why South Africa could not manufacture the steam generator locally. The following is a summary of the issues raised on the site visit.

Once a steam generator is received, it takes a few weeks to finalise receipt inspection. To manufacture steam generators for a nuclear power plant, you need to be registered with the National Nuclear Regulator (NNR). There are no South African companies which are registered to do this. When a steam generator arrives, it takes 3 months to prepare the unit as there was an elbow that needed to be welded to the SG. Once this is done, it is assigned to the unit and cannot be interchanged between units.

Framatome has the unit made in China, while the forging is done in Japan. The SG comes in 9 sections from Japan and welded by the Chinese. The contract for the SGR is R5 billion for the manufacture, design and installation for all 6 SGs. The whole project will be delivered for R5 billion. Eskom has maintenance contracts with Framatome, for maintenance and support. South Africa does not have capability for nuclear plant/steam generators as there are no other nuclear plants in the country. The contract with Framatome has a skills development set-aside.

Local companies are involved in the SGR project. The SGR is still in the timeframe for August, waiting on arrival of the SG. It takes approximately 55-60 days to replace a steam generator. Each unit will get 3 new steam generators. The lifespan of the steam generators is 30-35 years, designed for 40 years. The SG usually run longer than 40 years with good maintenance, however every 10 years' assessments are done on the nuclear power plant to see if the life span can be extended. If the SG is not replaced by 2024, there is a risk of the unit being shut down. There is a risk that the SG for Unit 2 will not being replaced by next year (i.e. 2023).

2.4.1 Resolution and way forward

The Committees were unable to engage fully on the complaint of the National Union of Mineworkers and on the presentation by Eskom on the current status of the national grid due to time constraints. The delegation resolved to reconvene a joint follow up meeting, where these matters would be fully ventilated.

On the 30 August 2022, there was a joint follow up meeting to afford Eskom an opportunity to respond to the allegations made by the National Union of Mineworkers. Eskom opted not to respond to the allegations, citing the issues raised by NUM, are labour related and should be dealt within the recognised channels within Eskom. The Committees rejected the assertion of Eskom and defended the right of the union to raise any matter which is the interest of the public with Parliament. A decision was taken for Eskom to submit a written submission, which was presented in a subsequent meeting of the 27 September 2022.

2.5 Observation

The Committee made the following observations:

2.5.1 The Committees noted with concern the reported delays and alleged corruption regarding the steam generator replacement project at Koeberg nuclear power station.

2.5.2 It was alleged by the union that the contractor, Framatome, responsible for the replacement of the steam generator had not delivered on its contractual obligation however it continued to be paid.

2.5.3 It also noted the allegations that Managers that were responsible for the steam generator project were suspended to protect the French based company.

2.6 Recommendations

Having engaged both Eskom and the National Union Mineworkers, the Committees resolved to embark on a follow up oversight visit to Koeberg power station for an in-depth investigation on the serious allegations of corruption at the plant.

3. Meeting with the liquidators of South African Express Airways Liquidators

The Committee met with the Liquidators represented by Mr Aviwe Ndyamara, the Officials of the Department of Public Enterprises led by Adv L Makobe. The meeting took place at the Department of Public Enterprises offices, in Pretoria.

On 6 February 2020 the Company was placed under Business Rescue Proceedings by virtue of an order of the South Gauteng High Court. On 28 April 2020 the Company was then placed under Provisional Liquidation by virtue of an order of the South Gauteng High Court. On 13 May 2020 the Office of the Master of the High Court issued a Certificate of Appointment, appointing the following provisional liquidators: Mr Aviwe Ntandazo Ndyamara; Mr Kgashane Christopher Monyela; Mr Clifford Thabang Maredi; Ms Soria Marias and Ms Samantha Fay Margolis-Pantellias.

3.1 The status of the provisional liquidation of South African Express Airways

3.1.1 The sale of material assets

The total proceeds received from the disposal of the company assets to date is in the amount of R 24 748 700 00 (twenty-four million seven hundred and forty-eight thousand seven hundred rand) only. The ongoing inquiry is attending to the collection of debtors. The intangible asset sale is underway.

3.1.2 Employees of South African Express Airways

The employees' claim documents have been completed, the claim will be claims against the company, and payable from the free-residue of a liquidation and distribution account, after the payment of secured creditors. The employees enjoy a special preference in terms of the Insolvency law, but are only paid after the secured creditors claims have been settled. At this stage, the liquidators do not foresee a dividend payable to the concurrent creditors.

As of the 28 April 2020, the granting of the provisional order, the employee's salaries were outstanding for March and April 2020. The outstanding remuneration will be dealt with as claims against the Company. The implication of the provisional order granted is that employee's employment contracts were by law immediately suspended.

Temporary Employer/Employee Relief Scheme (TERS) Unemployment Insurance Fund (UIF) for the month of April and May 2020 were processed and received by the employees.

Currently, the following has been completed for the employees:

- UI 19' forms;
- (ii) Salary Schedules;
- (iii) Section 38 letters;
- (iv) Claim forms;

The Financial Sector Conduct Authority (FSCA) appointed a liquidator for the Retirement and Pension Funds. The liquidator was appointed on 29th June 2021 for the Retirement Fund and 8th July 2021 for the Pension Fund.

3.2.2 Progress on actions taken to date

Action	Progress
The sale of the material assets of the airline	Complete
The section 417/418 enquiry into affairs of the airline	Ongoing
Status update meeting with the shareholder (DPE)	Ongoing
Status update to creditors via Circular	Ongoing
The status of the final liquidation order.	The provisional liquidation order postponed 4 July 2022
The preliminary report of the section 417 and 418 enquiry	Ongoing

The timelines associated with the intangible asset sale.	As per circular to creditors dated 19 April

3.3 Findings

The Committee made the following findings:

3.3.1 Noted that there is progress in the liquidation process however was concerned at the timelines as this process has taken longer than anticipated.

3.3.2 SAX had no funding post BRP then it had to be liquidated, the Committee noted how the State Capture has destabilised SOCs' governance, operationally and financially.

3.3.3 Noted that according to the Commissioner's findings there is evidence of reckless trading at SAX.

3.3.4 There were challenges with the initial bidder in raising the balance of the purchase price to fund the purchase of the airline.

3.3.5 Noted that fair value of the intangible assets is as valuable as whoever is willing to pay for it. Valuation was based on the intention to sell the airline to a party willing to capitalise. It is not transferable and requires government consent. The sale of intangible assets is the responsibility of SAX.

3.3.6 Noted that the aim of liquidation process is not to bring criminals to account but to recover. The process is transparent at all times.

3.4 Recommendations

The Committee recommend that the Minister of Public Enterprises should consider:

3.4.1 Ensuring that the liquidation process is done in a transparent manner.

3.4.2 Ensuring that there is clear communication amongst stakeholders about the liquidation process.

3.4.3 Ensure that systems are put in place to ensure that no other state entity would go through this process.

4. Oversight visit to South African Airways

The Committee visited the board and executive of South African Airways at their Headquarters, Airways Park. The purpose of the meeting was to receive a briefing on the progress update on the sale transaction to the Takatso consortium and the operational performance report. The report entailed the following issues:

4.1 Mango

Below is a table illustrating the process of Business Rescue Proceedings (BRP) of Mango Airline and progress that has been made.

	BR Plan	Amended BR Plan
Ownership	To be sold 100% to new investor (“**Investor**”).	To be sold 100% to new investor (“**Investor**”).
Operations	Resumption planned for December 2021 at a reduced scale.	Resumption after on-boarding of the Investor.
Fleet	3 best aircraft from current lessor, with additional capacity met through short-term ACMI leases.	5 – 8 aircraft, assuming the Investor will relaunch operations in accordance with the Company's business plan.
Aircraft Leases	Enter into short-term (6 months) renewable leases with current lessor at reduced rates on a limited fleet.	All leases to be cancelled and aircraft returned to the lessor. Investor to make own arrangements.
Staff Complement	Reduced from 708 to 412 in line with reduced level of operations.	All 708 employees offered Voluntary Severance Packages ("**VSPs**") and/or retrenched and limited staff re-employed on short-term contracts for care & maintenance until Investor comes on board.

The remaining 104 permanent employees will go through a section 189 retrenchment process, which commenced on 24 January 2022 and will be completed on or before 21 March 2022.

4.1.1 Strategic Equity Partner

An Expression of Interest (EOI) was published on 2 December and closed on 20 December 2021 with 10 applicants. Since the EOI were incomplete, closing date was extended to 4th Feb 2022. Six were shortlisted, due diligence commenced till March 2022.

4.2 Human resources

The group has a total of 786 employees. There are 50 employees at Cargo until outsourcing is finalised. There are 17 employees at Information Technology until outsourcing is finalised. There are five members of Executive Committee, 13 working in flight operations, 9 in general operations and 55 working in other departments.

There are 149 short term contracts mainly in Cargo, IT, GOCC, In Flight crew and Human Resources. There are 89 Pilots that have been placed, of which 38 is white and 51 are black. There is also a training layoff scheme, which sought to reskill redundant employees with skills for the market, the training expired in March 2022. An amount of 161 employees exited the system at the end of March 2022. There are another 49 employees who are working on projects and will be exiting throughout the year, while 10 employees are in training positions.

4.3 Airchefs

The strategic goal of the Airchefs is to increase revenue mainly through new customers and diversification. To improve efficiency and effectiveness of operations through reduction in operational costs, higher yields in production of meals and less reliance on SAA revenue. The recapitalisation of R218m was used mainly for retrenchment pay-out and back pay; settlement of creditors (most with 30% discount); and working capital. Employee numbers have reduced from 1149 to 234.

4.3.1 Progress on strategy

Airchefs is expected to be profitable from February 2022. There are ongoing meetings with potential customers (British Airways and Virgin) and on-going engagements with non-airline customers (Transnet, Shell). There are improved productions processes (including an in-house bakery). In order to transform the company to world class, it will need an investment in capex of R20m per annum for five years. The company will also utilise key partnerships that SAA has with other airlines/countries (e.g. through Star Alliance) and consider a strategic equity partner.

4.4 SAA Technical

South African Airways Technical (SAAT) operates a full-service Maintenance Repair and Overhaul (MRO) organisation, one of the largest in Africa. SAAT has held full and uninterrupted US Federal Aviation Administration and European Aviation Safety Agency approvals since the late 1980s, serving a range of local and international airlines.

Market segments include major airframe checks; engine minor defect rectification; mechanical components; avionics; and line maintenance.

The business has stabilised and this is some of the progress that has been made:

- The section 189 process is now complete;
- Cost Reduction and Cost Improvement initiatives have resulted in a current monthly saving of R10m per month. Further initiatives are underway to increase these savings;
- SAAT has secured and completed five additional heavy maintenance checks over the past three months which have contributed positively to the bottom line;
- Through key interventions in the operational and supply chain areas these checks have been completed within the targeted dates. This is a significant improvement on turnaround times when compared to previous turnaround times on similar projects.

SAAT has begun the second phase of its plan which involves:

- Increasing and diversifying its customer base;
- Engaging the hearts and minds of its people to realise its envisioned future together;
- Developing an effective material management and planning system;
- Implementing efficiencies in operational delivery performance, quality performance and productivity performance, to ensure that SAAT is able to secure a strong customer base whilst driving reasonable profit margins.

4.5 SAA Fleet plan

The airline has a restart fleet comprising of six aircraft i.e.; three A319s, two A320s and one A330 on power by the hour lease agreements. The leases are for a maximum of two years; the aircraft may be returned to the lessor after giving a relatively short period of notice. The airline will be determining the long term fleet requirements and will be embarking on a fleet replacement programme for both narrow and wide body aircraft. A two type fleet (one narrow body and one wide body) will be the most efficient and flexible going into the future. The interim fleet will be exited as the airline procures new aircraft. The disposal process of SAA’s owned A340 aircraft is at an advanced stage and one A340 aircraft will be retained to be used for charters and as a backup aircraft.

The fleet plan includes utilising high density seat configurations with more seats in economy class and fewer seats in business class. A total of 26 aircraft will secured over the next 5 years; 14 narrow body and 12 wide body fleet through operational lease with security deposits payable prior to delivery.

4.6 Strategic equity partnership

Government had taken a decision that SAA needed to be saved and not liquidated. Government had indicated that it had no funds to continue supporting SAA for future operations. A number of Expressions of Interest (EOIs) for SAA as a group or one of its subsidiaries were received during the course of the business rescue process. It was approved by Cabinet that DPE identify and conclude an agreement with an SEP on behalf of Government. The pandemic had a significant impact both on the South African fiscus and on the aviation industry. All interested parties made it clear that Government had to take responsibility for all historic costs. At the same time, Government required that the SEP needed to provide all the finances for the new airline. DPE therefore required a SEP with capacity to finance the operations of SAA with no Government financial support from the conclusion of the SEP process. DPE also required the SEP to have the ability to bring aviation skills to the partnership. "*It is important to clarify at the outset that the disposal of shares transaction is not a procurement process as envisaged in section 217 of the Constitution. Section 217 of the Constitution applies when an organ of state contracts for goods and services. The disposal of SAA shares is a merger and acquisition transaction. Notwithstanding the distinction between procurement and this type of transaction, the Department undertook a fair, equitable, transparent and competitive process. The overall objective was to obtain the best outcome for the airline and the country."*

4.7 Process for selection of SEP

A Transaction Advisor was appointed (Rand Merchant Bank ("RMB"). The DPE appointed RMB on 29 July 2020. Its mandate was to evaluate the EOIs received by the Department for shareholding in SAA. This process was structured in three phases:

- **Phase 1 – EOI evaluation:** Assessment of EOIs against selection criteria agreed with the DPE to identify credible SEPs to progress with to Phase 2. Interviews were conducted with all interested parties.
- **Phase 2 – Proposal development:** Engage credible SEPs to develop a viable transaction proposal that meets the objectives set by Government.
- **Phase 3 - Implementation:** To the extent a viable transaction proposal could be agreed with a SEP, to advise on the finalisation and implementation thereof.
- As a result of the extended duration of the pandemic, and its impact on both global and domestic aviation, some of the parties who had expressed an interest could not provide the capital required to operate the airline.
- From the interested parties, Harith General Partners was willing to provide the funding for the new airline and it partnered with Global Aviation for aviation management expertise. The Takatso Consortium was formed by these entities.

4.8 Findings

The Committee made the following findings:

4.8.1 Noted that there are financial constraints and the challenges in the market, however emphasised the need for maximising presence and expanding the local routes.

4.8.2 Concerned regarding the emphasis of profit maximisation over advancing developmental objectives.

4.8.3 Noted that there are ongoing litigation cases between SAA and unions, and all unions were involved and consulted with the assistance of the CCMA.

4.8.4 Clarity was sought on the possible impediments that may prohibit optimum performance, and what assistance is required from DPE and Parliament?

4.8.5 Clarity was sought on various equity partners and SAA's partnerships.

4.8.6 Noted that the company is implementing financial prudency and adherence to timeframes, remote working and cost containment on leases.

4.8.7 Urged the SOC of the need to support and promote local businesses, particularly youth and women owned businesses.

4.8.8 Clarity was sought on the procurement processes and impediments

4.8.9 Noted that there are plans to increase fleet through power by the hour, it will be more cost efficient

4.8.10 The rationale with partnerships is to share the risks and income.

4.8.11 Noted with concern that there are impediments emerging from trust from the market and red tape in procurement

4.8.12 Was informed that the decision to determine the routes is informed by data analysis and the target market

4.8.13 Noted that the airline is aiming at year three to make profit and break even.

5. Recommendations

The Committee recommend that the Minister of Public Enterprises should consider:

5.1 Ensuring that the satisfaction of all conditions precedent and regulatory approvals are met for the conclusion of the transaction.

5.2 Increasing the stake of government in the shareholding of SAA, in case the consortium is unable to raise the required capital.

6. Oversight visit to Denel

The Committee undertook a joint oversight visit with the Standing Committee on Appropriations to the Denel Headquarters at Centurion for engagements with Denel and Armscor on 22 April 2022. The thrust of the session was to receive briefings from the two stakeholders on the following:

- South African Defence Industry risk occasioned by a plethora of challenges experienced, exposure and reliance on Denel; and
- Armscor's capacity to deliver on defence contracts and the assessment of the risk to South Africa`s sovereignty in the event credit guarantees are enforced by respective lenders.

6.1 Current state of Denel

6.1.1 The year to date balance sheet shows that Denel is technically insolvent. Available cash is insufficient to meet operational requirements, including the payment of salaries and suppliers. At end January 2022 Denel owed R830m to employees and related costs and circa R900m to suppliers.

6.1.2 The latest cash flow projections for the 2021/22 financial year indicate a negative R600 million, if no mitigation action is taken.

6.1.3 The current tax status is "non-compliant" due to the substantial tax liability that remains unpaid. The total amount owed to SARS is R529m to date, made up of VAT of R83.7m, PAYE of R440m and Corporate tax of R5m.

6.1.4 Following Denel's position not to submit the annual financial statements for 2021 financial year before 30 October 2021, the JSE communicated concerns on Denel's ability to meet the Debt Listing requirements. The JSE went ahead and suspended the Denel listing at the beginning of February 2022.

6.1.5 The uncertainty on Denel's future state has impacted the current customers who are concerned about Denel's ability to deliver on contracts on hand leading to a possible call on prepayment and performance guarantees (circa R3,4bn).

<u>Outstanding tax payments and SARS status</u>

6.1.6 The current tax status for the group is "non-compliant" due to the substantial tax liability that remains unpaid.

6.1.7 The non-Compliance is having an impact on the various Armscor / Denel contracts. The current difficulty to remain tax compliant is not limited to Denel, but is experienced by other companies in the local defence industry too. Some of Denel's critical local suppliers are already non-tax compliant and Denel can neither place orders on them for critical supplies.

6.1.8 This matter will compromise system availability, national security and foreign deployments.

<u>Armscor Programme Penalties</u>

6.1.9 The enforcement / deduction of penalties before progress payments are made result in a negative impact on Denel's cash-flow and compounds Denel's liquidity crisis.

6.1.10 The waiving or deferment of these penalties until the company and its business is stabilised would contribute significantly to Denel's capabilities recovering.

<u>Legal matters</u>

Denel is currently defending the following legal matters:

6.1.11 Application for liquidation by SAAB. The matter has since been removed from the court roll following an out of court settlement agreement. SME Infratech applied to court to join the proceedings as a co-applicant and the parties are attending to the exchange of pleadings. Denel does not oppose the joinder but is opposing the application on the merits of the claims and the order the applicant is seeking.

6.1.12 The non-payment of salaries has led to applications in court by unions. The matter has been postponed to December 2022 allowing Denel time to comply with the August 2021 court order. Further applications by the unions have been awarded by the courts for subsequent non-payment of salaries.

6.1.13 Some employees in their individual capacity have submitted court applications for the amounts owed to them. This poses a threat to Denel's assets as execution orders to attach assets have been granted by the courts.

6.1.14 The threat of other suppliers making a similar application persists as increased letters of demand are delivered to Denel.

6.2 Funding Challenges

Significant restructuring cost is required for implementation of the new operating model in addition to operating cash requirements whilst the new model is implemented. In addition, Denel has incurred legacy obligations including arrear employee and trade creditors that Denel will be unable to fund from operations even under the new operating business model. Denel requires approximately R3.7bn immediately to deal with these obligations. A further R900m is required over the next 24 months to complete the turnaround plan.

The medium term position has improved somewhat with Government allocating funds for capital and interest payments of approximately R3bn related to the Domestic Medium Term Note (DMTN) programme, significantly improving the Denel Balance Sheet.

The Denel Balance Sheet remains liquid and needs to be restructured to provide liquidity to execute operations and generate new revenues. Denel has identified assets that can be sold to yield approximately R1,8bn over the course of the next three months to reposition the Balance Sheet to effectively support operations. Certain assets were identified as non-core from a commercial perspective, but is considered important by the DoD.

The total cash requirements for legacy debt and restructuring over the next 24months as reported still exceeds the amount to be raised from the sale of assets and will still require capital injection from the Shareholder for the company to remain operational in the short to medium term.

The possible cancellation of the Hoefyster contract poses an existential threat to the company and the sovereign and strategic capabilities housed for National Security with pre-payments of R2.2bn which may be called by Armscor.

7. Findings

7.1 Non-payment of salaries, concern regarding penalties due to inability to deliver contracts, concern on the technical insolvency of Denel and the fear of the entity being liquidated, lack of co-operation between Armscor, Defence and Denel, are some of the issues raised in the presentations.

7.2 The need for Denel and Armscor to open the market for youth, women and people with disability in the procurement space.

7.3 There is a deficit of over R500m on the funding of the corporate plan.

7.4 There is a restructuring process in place, all the six divisions will be converted into business units, and reduce the management structure of each business units.

7.5 In total Denel would need R6bn in order to pay debts and funding the shortfall of the working capital. National Treasury has been unable to give Denel a repayable loan because there is no facility to use to issue such a loan.

7.6 Workers have not been paid full salaries for over two years, Denel is only able to pay 20 – 30% of the salaries.

7.7 Denel has lost more than 300 highly skilled engineers and in so doing, lost intellectual property. The SIU is pursuing a company in the UAE for R3bn for theft of IP. The total amount lost due to IP theft is R18.5bn.

7.8 National Treasury raised concern on the cost structure of Denel.

8. Recommendations

The Committee recommend that the Minister of Public Enterprises should consider:

8.1 Fat-tracking the diversification programme of Denel and ensure that policy impediments are removed to allow government departments are allowed to partner with state-owned companies.

8.2 engaging the Department of Trade, Industry and Competition to address the policy impediments that prohibits public-public partnerships, and ensuring that Denel is a preferred supplier for all the security solutions for all the security agencies of the state.

8.3 Ensuring the resolution of all outstanding payment to employees, suppliers and creditors.

8.3 Present to the Committee the financial requirements of the entity over the MTEF.

Report to be considered