



DENEL'S PRESENTATION TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS (SCOPA)

06 JUNE 2023



Standing Committee On Public Accounts:

Briefing by Denel on key developments.



PRESENTATION OVERVIEW

- 1. Implementation Status of Denel Turn-Around Plan**
- 2. Denel Liquidity and Funding**
- 3. Status of Annual Reports**
- 4. Status of Irregular, Fruitless and Wasteful Expenditure**
- 5. Status of Investigations by Denel**
- 6. Presentation by SIU on Denel Matters**
- 7. Conclusion**



IMPLEMENTATION STATUS OF TURNAROUND PLAN

Denel SOC Ltd is a state-owned commercially-driven company and strategic partner for innovative defence, security and related technology solutions. It groups together several defence and aerospace divisions and associated companies with the primary purpose of designing, developing, manufacturing and supporting defence matériel that remains critical for the local defence force to execute its constitutional mandate to safeguard the citizen of South Africa.

DEFENCE REVIEW 2015

Introduction Paragraph 12 states:

The policy principle of preventing armed conflict is achieved by taking all political, diplomatic, informational, societal and military measures to deter potential aggressors. South Africa's international stature and balanced suite of defence capabilities contribute to overall deterrent capability and posture. This is characterised by credible combat forces, operational prowess, rapid force generation through trained Reserves, demonstrated ability in field training, technological and doctrinal competence, and the visible morale of personnel.

Section 15 Paragraph 95 states:

Denel is a national security asset, with the primary purpose of designing, developing, manufacturing and supporting defence matériel. In addition thereto, Denel is charged with:

- a. The custodianship of assigned sovereign or strategic defence capabilities, technologies and abilities, inclusive of those that may be at risk, the loss of which would threaten South Africa's required defence capability.*
- b. The design, development, manufacture and support of important capabilities which may not be commercially viable.*

From a Geopolitical perspective, the SANDF is dependent on a significant “level of effort” and capability from Denel to support their preparation and readiness for deployment both Internally (such as during July 2021 unrest and recent KZN floods) and Externally (such as in the DRC and Mozambique) to South Africa.

Denel is an OEM and / or MRO Authority of numerous critical systems of the SANDF, e.g.:

SA Army

- Denel Badger Infantry Fighting Vehicle
- Denel Casspir Armoured Personnel Carriers
- Denel G6 Renoster Self-Propelled Howitzer
- Denel G5 Luiperd Towed Howitzer
- Denel Bateleur MRL
- Denel Ingwe Anti-Armour Missile
- Ground-Based Air Defence System (GBADS)
- Ratel Comms upgrades for GBADS

SA Air Force

- Denel Oryx MTH
- Denel Rooivalk AH
- Lockheed Martin C-130BZ
- Denel A-Darter Air-to-Air Missile
- Denel Mokopa Anti Tank Missile
- Denel MII ECS at JARIC - Waterkloof

SA Navy

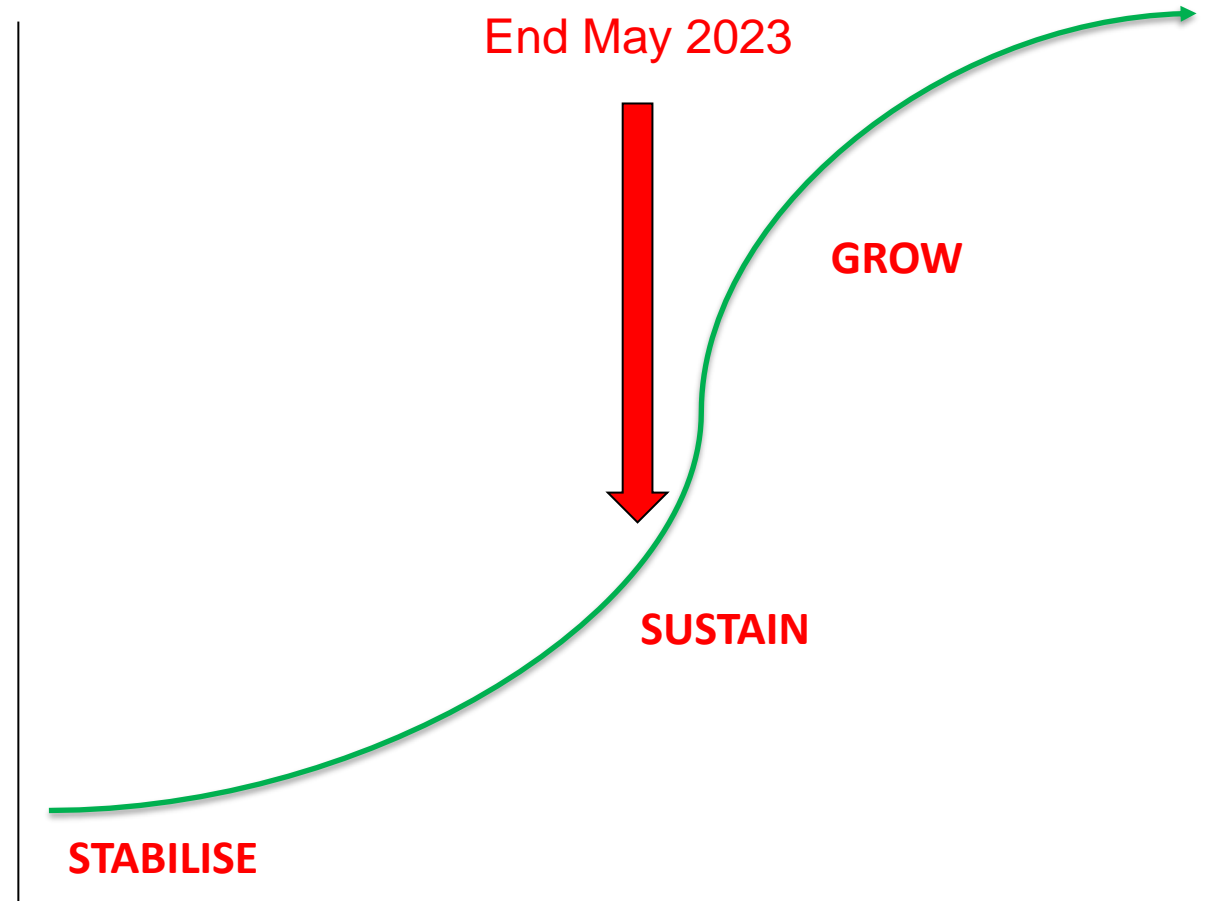
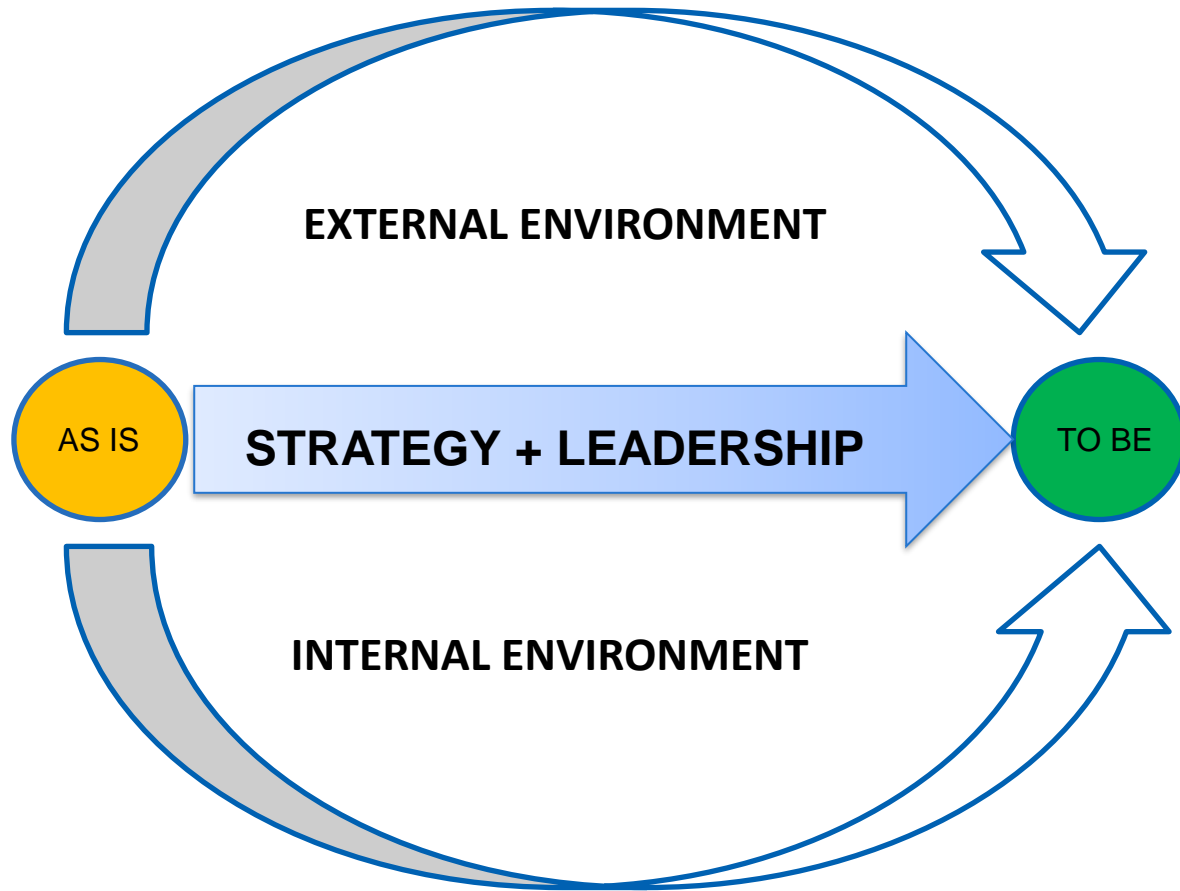
- Denel 35mm Dual Purpose Gun
- Denel Umkhonto IR Surface-to-Air Missile
- Denel GI2 cannons for IPVs

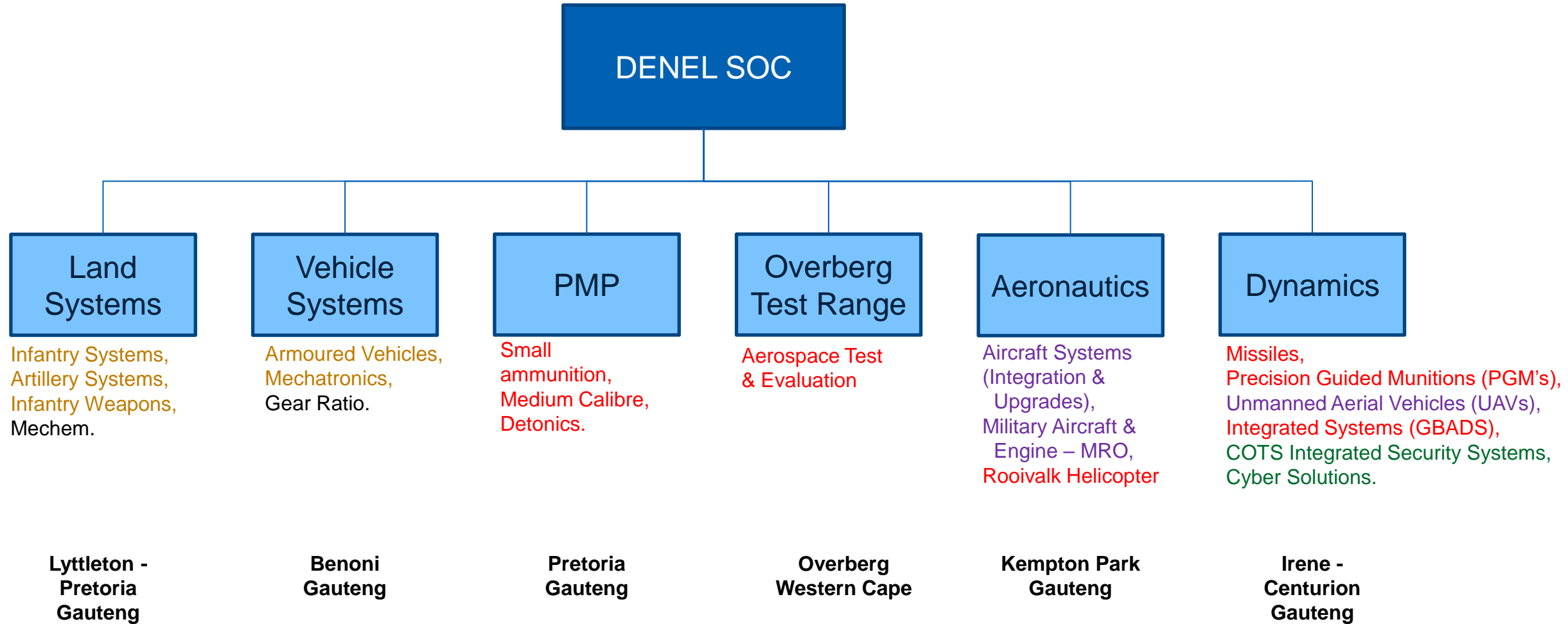


The loss of Denel's capabilities means that the SANDF will:

- No longer have security of supply and reliant on imports for equipment;
- Be disadvantaged as an informed purchaser of defence products able to customise equipment requirements;
- Be unable to hedge against the cost of foreign currency denominated purchases, capital and support; and
- Lose the local defence components manufacturing industry.

- 24 & 25 November 2022 – Denel had the Badger Vehicles, T5 Artillery Systems and numerous other products on display at THE CHIEF OF THE SA ARMY DISTINGUISHED VISITORS DAY at the SA Army Combat Training Centre, Lohatla
- 22 to 25 February 2023 - A modest presence of Denel Board, Execs and Management at the IDEX23 Defence Exhibition in Abu Dhabi proved to be valuable for refreshing existing markets / relationships as well as pursuing new opportunities and new markets.
- 17 to 22 February 2023 – The various variants of Denel Badger vehicles were on display and participating in exercises, night firings and a SA Army Parade at the SA Armed Forces Day activities in Richards Bay.
- 16 March 2023 – Briefing to the Joint Standing Committee on Defence on *“Denel’s ability to support the SANDF following the Medium-Term Budget Policy Statement (MTBPS) allocation.”*
- 27 March 2023 – Presentation of the JSCD Slides to the Military Command Council with Armscor & Denel Executive teams for aligned understanding and way forward.
- 28 March 2023 – CRO and Denel Executives Meet with Chief of SAAF – Discussion on C130, Rooivalk and Oryx Support. Agreed to set-up a Joint SAAF / Denel Project Team to resolve the current support difficulties and expedite improvement.
- 29 March 2023 - Portfolio Committee on Defence and Military Veterans (PCODMV) Oversight at Denel – Helicopter Maintenance Support Facilities at Denel Aeronautics – Kempton Park.
- 3 April 2023 - MCC Oversight Visit & Presentation on Denel Air, GW and ISS Capabilities with associated facility visits and capability demonstrations at Kempton Park and Irene Campuses.
- 4 April 2023 - MCC Oversight Presentation on Denel Land Capability with facility visits and capability demonstrations at Lyttleton for Artillery, Infantry and Vehicle Systems and the Small and Medium Munitions capabilities at the two PMP facilities.
- 5 April 2023 – PCB on Hoefyster held – DoD Governance Process to consider the restart of Phase 2 (AACB, AASB, AAC) to follow.
- 2 May 2023 – Denel Turn-around Planning and Status to the Council on Defence
- 11 May 2023 – Presentation to the Extended Army Command Cadre (EACC) on Denel Landward Programmes and support capability. With a visit by the EACC to Denel’s facilities on 12 May 2023.

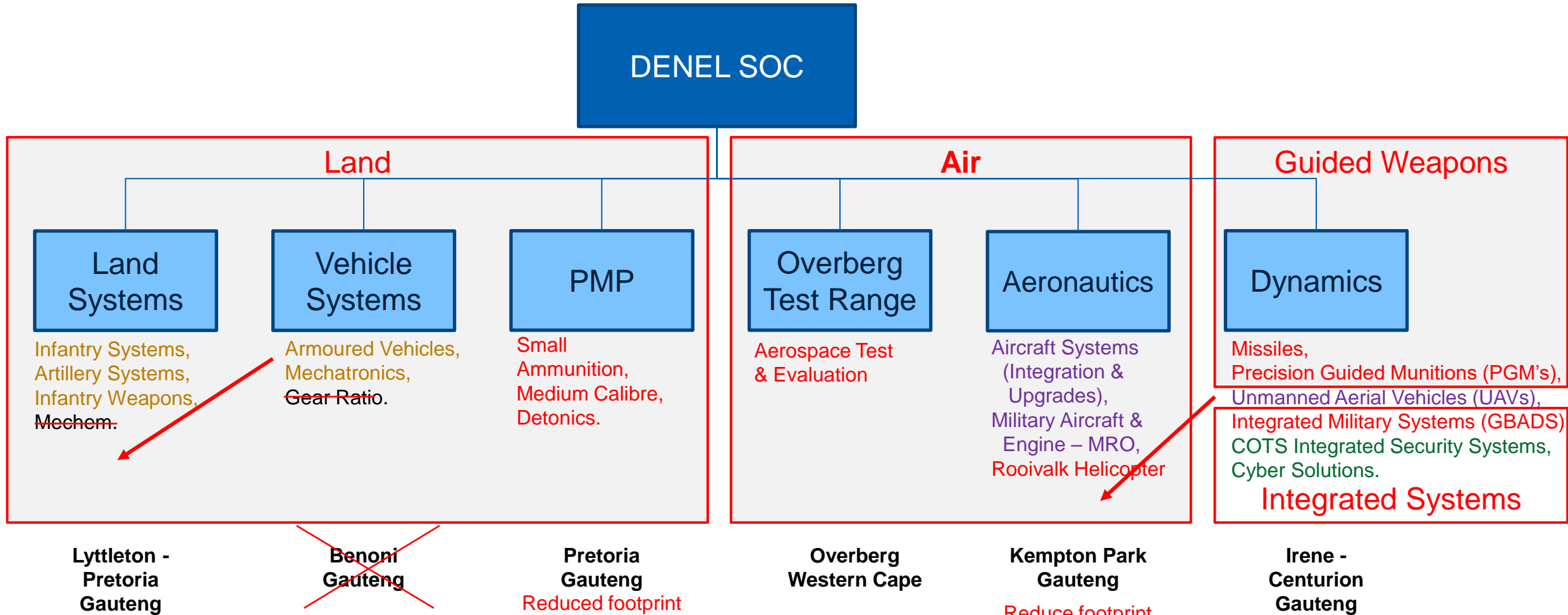




Sovereign Capability
 Sovereign & Strategic Capability
 Strategic Capability
 Growth Capability
 Non-core

Key Parameters

Headcount : 2206
Revenue : R 1 946m
Cost Base : R 1 971m (Excl. Materials & Subcontracts)
Net margin : -39%
Productivity : 1.1



Sovereign Capability
 Sovereign & Strategic Capability
 Strategic Capability
 Growth Capability
 Non-core

Key Parameters

Headcount : 1 316 - 80% are core technical skills to retain critical mass
Revenue : R 2 756m
Cost Base : R 1 469m (Excl. Materials & Subcontracts)
Net Margin : 10%
Productivity : 3:1 (targeting 5:1)

The proposed future **structure for Denel's core capabilities** is to have a direct link to the **dimensions of defence with a Land, Air and more complex Integrated Systems grouping** to exploit new opportunities and emerging technologies. Hence the logical consolidation of Land and Air to improve efficiencies, remove redundancies and level over the gaps in capabilities.

Besides the exiting of non-core / unprofitable business which is already in progress, and the obvious benefits expected from a reduced executive structure, shared support services, standardised policies & processes, and reduction footprint and other overheads, **other key structural impact initiatives are as follows:**

The **relocation of the DVS capability** to the Lyttleton DLS facilities is **to capitalise on the significant shortage of skills in the DVS capability, avoid the urgent backlog investment in infrastructure and facility refurbishment required in Benoni** by relocating into appropriate underutilised facilities in the Lyttleton campus. The merging of capabilities within the Land facilities **will allow for consolidation of the overheads and scarce resources**. The **once-off cost to relocate and restore the DVS capability at the Lyttleton facility is estimated to be around R46m** with an **annualised benefit of R68m** and a return from the **sale of the property expected to be approximately R80m**.

The **relocation of the UAVs capability** to the Kempton Park based Air facilities initiative is **to capitalise on the significant overlap in airborne platform capabilities between Aeronautics and Dynamics (UAVs), solve skills shortages in the DD (UAVs) capability and consolidating on one site**, thereby also freeing up the Irene footprint for the property optimisation initiative. The **once-off cost to relocate and restore the UAVs capability** at the Kempton facility is **estimated to be +/- R3m** with a **return from the property expected at R40m**. An overall reduction of the Irene footprint is **expected to save / earn up to R60m pa** going forward.

The **separation of the Guided Weapons capabilities** of missiles and precision guided munitions is **to enable a focused protection and restoration of the severely depleted capability** to enable the development of the processes that are required **to bring in the scarce leadership and critical skills, partner and contract for urgently required capabilities that are available in industry and secure the urgently needed external funding to return to viability**.

The **lifting of the Integrated Systems capability** out of Dynamics is to ensure that the efficiencies and performance in the **existing Integrated Systems programmes are protected and able to remain agile in order to expedite targeted opportunities in complex integrated systems growth area**, develop knowledge in new advanced technologies emerging in the defence sector, **and diversify its integration capabilities towards non-defence security opportunities offered by other SOEs and in the commercial market**.



CONSOLIDATED & RESTRUCTURED DENEL - OPERATING MODEL

Approved JULY 2022

Core skills allocated to the structure to **maintain a critical mass for all key capabilities** to execute programmes, partner with industry and ramp-up as operational requirements dictate.

Denel SOC
Holding Company Concept
(R&D, Innovation, IP Development & Integration)

Denel Associates & Subsidiaries
Rheinmetall Denel Munitions (Large)
Barij Dynamics (UAE) (PGM's)
Hensoldt Optronics (SA)

Commercial
Business Development, IP Registry & Management, Offset Management, Compliance and Properties

Guided Weapons
Innovation, Design, Engineering, Modelling, Upgrades, Assembly, Test and Support
Restore core and rebuild

Land
Research & Development, Innovation, Design, Engineering, Manufacturing, Assembly, Test & Support
Strengthen core and diversify

Air
Research & Development, Innovation, Design, Engineering, Integration, Upgrades, CAW & MRO
Strengthen core and grow

Integrated Systems
System Level: Design, Engineering, Integration, T&E, ILS, Commissioning and Support
Diversify to Commercial / SOEs

Key Products / Systems
Missiles and Precision Guided Munitions (PGM's) supply and support

Key Products / Systems
Infantry, Artillery, Armoured Vehicles, Mechatronics and Infantry Weapons Products supply & support.
Small Weapons Ammunition & Medium Calibre Munitions supply.

Key Products / Systems / Services
Military Aircraft & Engine MRO, Aircraft Systems Integration & Upgrades, Rooivalk Helicopter, Unmanned Aerial Vehicles, Aerospace Test & Evaluation (@OTR) and other Aerospace products and support

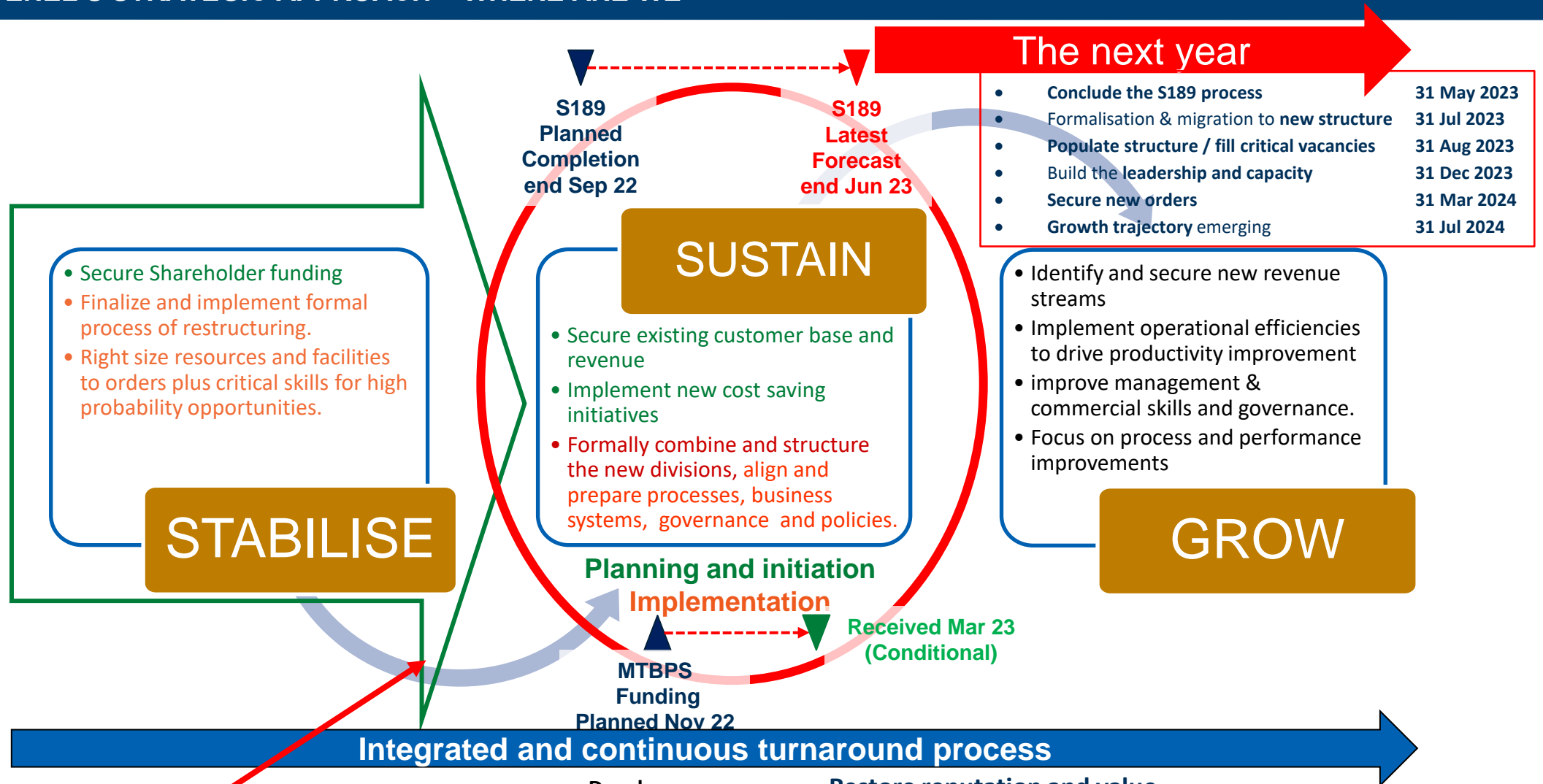
Key Products / Systems
Complex Integrated Systems - Military (eg GBADS), COTS Security Systems and Cyber Solutions supply and support

Shared Services
Human Resources, Financial Services, Legal Services, Risk / SHEQ / Configuration, Business Development, Supply Chain, Communications, ICT Services

Model built on a **foundation of standardised Governance, DoA, Policies, Practices, Standards and Business Management Systems**

Industry involvement and development through supply chain with PPPs for lower level production, manufacturing and support

NEW CUSTOMER / MARKET FACING OPERATING MODEL



Note: Process stalled in transition from “Stabilise” to “Sustain” due to recap delays to support Denel’s cashflow (received end Mar 23 vs Nov 22) and completion of S189

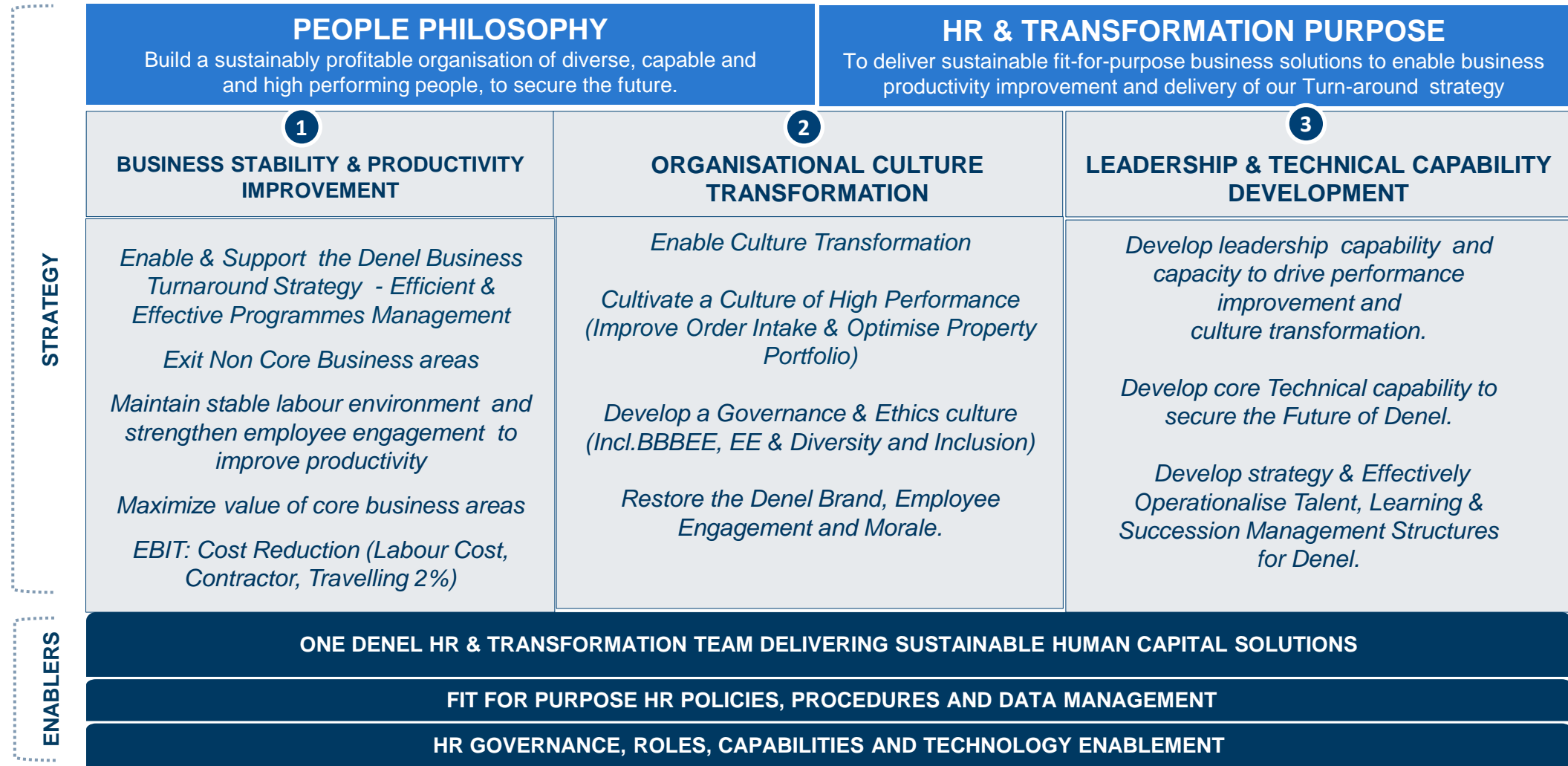


TALENT MANAGEMENT

SHAREHOLDER COMPACT

DENEL TURNAROUND STRATEGY-CORPORATE PLAN

DENEL HR STRATEGY



VALUES

Performance

Integrity

Innovation

Caring

Accountability

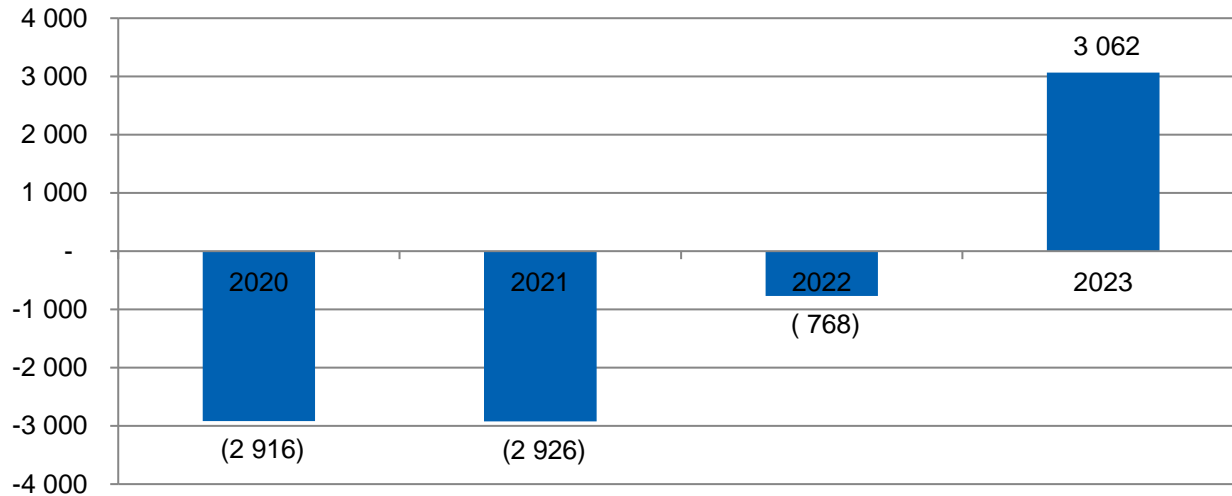
DENEL HR STRATEGY

- **The HR Strategy has a strong focus on reframing Denel on the correct skills sets**
- **To this end there is both a requirement in gaining external skills and maximizing skills internally**
- **An Integrated Talent management strategy has been developed to illustrate how various key elements will flow into each other**
- **This includes the National imperatives, and other macro influences to internal processes**
- **The Denel Technical Academy is being reorganized to be able to fulfill many of the learning initiatives identified.**

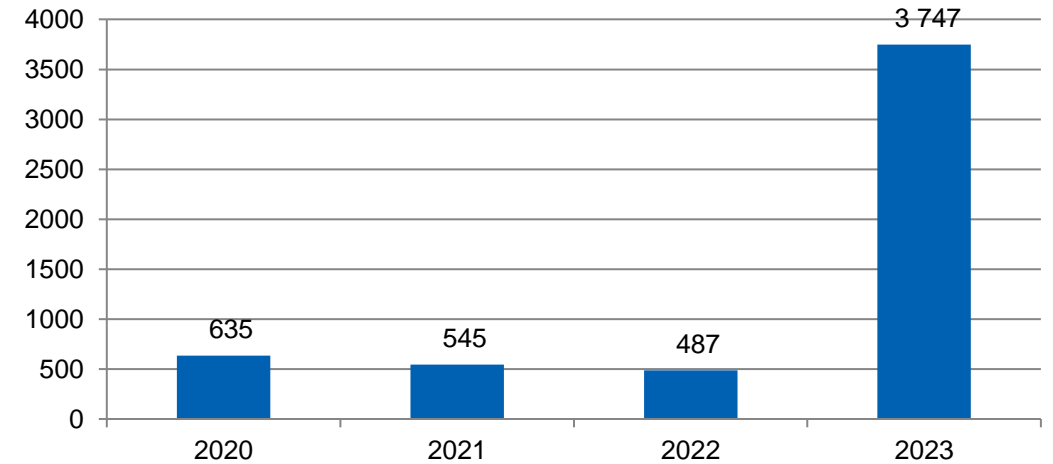


DENEL LIQUIDITY AND FUNDING

Solvency



Cash



- Since FY2020, Denel had remained insolvent and with poor liquidity position
- During FY2021, F2022 and FY2023 Denel received R416m, R3.03bn and R205m for the repayment of bonds against the guarantees issued by the government.
- Whilst this improved the solvency position, it did not address the operational challenges it faced until the unbundling of its Medical Benefit Trust (DMBT) and the recap both received in FY2023.
- The DMBT and recap received allowed Denel to successfully defend liquidation applications by suppliers (e.g. SAAB Grintek) and asset attachments by unions and employees.



DENEL LIQUIDITY - FUNDING

Denel Funding Requirement	Recapitalisation utilisation original request	Recapitalisation utilisation after DMBT application
Business Case Critical Funding Requirement to Stabilise	977	628
Restructuring Costs	577	405
DMTN payment	0	100
Working Capital requirement	400	123
Business Critical Funding Requirement for Growth and sustainability	900	900
Further Optimisation Restructuring Cost	180	180
Critical Capex	120	120
Strategic Resource Operational Maintenance	280	280
Growth Working Capital Requirement	320	320
Total business case funding requirement to financial sustainability	1877	1528
Current and Legacy Obligations	3323	2772
Legacy obligations (Airbus, DRC, Chad, T5, overdraft, onerous contracts & c	521	521
Armscor HY Loan & Creditors	600	600
Trade Creditors	963	753
Operational cash losses 2022/23 before implementation of Restructuring	102	0
Arrear Employee Obligations (PAYE obligation relocated to SARS)	908	75
Exit of loss making contracts - performance guarantees, pre-payments and SARS	118	118
	111	705
Total recapitalisation and funds from sale of non-core assets	5200	4300

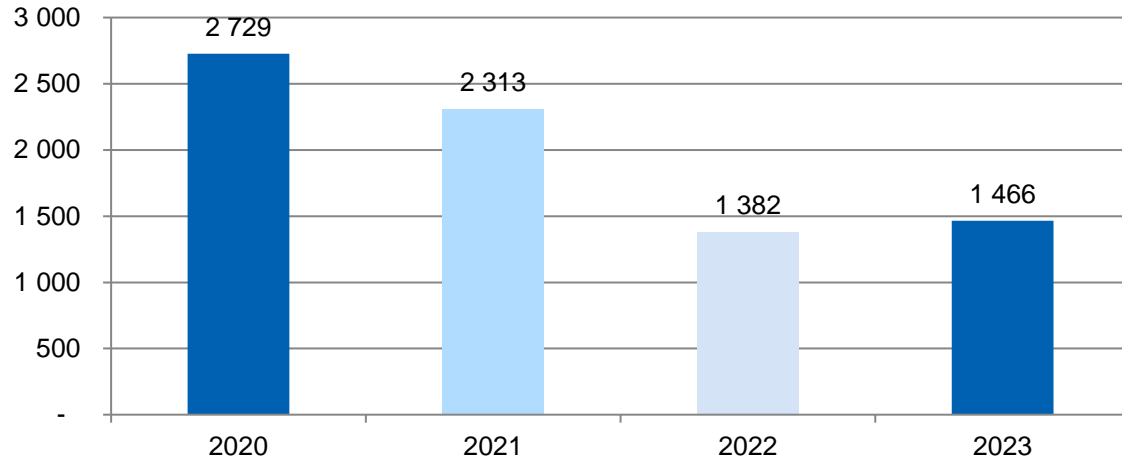
- **Recapitalisation required** for turnaround plan amount to **R5.2bn**, through recapitalisation of R3.4bn and the sale of non-core assets of R1.8bn.
- **R992m received** in August 2022 through unbundling of the DMBT utilised mainly on working capital to restart operations and normalise labour relations
- The **stabilisation phase** was largely completed and **implemented** with this funding
- **Recapitalisation funding of R3.4bn** received in **March 2023** of which R605m spend to date mainly in **operations, restructuring** and **towards legacy** obligation e.g. Venezuela, SARS payment plan
- This has allowed significant **progress** to be made on implementation of the **sustainability phase** of the turnaround plan.
- The **balance of the funds** will largely be spend to clear **legacy obligations** and support the **growth phase** of the plan

Scenario 1 - Full Recapitalisation and sale of non-core assets - Corporate Plan								Nov	Dec	Jan	Feb
Consolidated Cashflows with strategic overlay											
	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Opening cash balance	3 369 457	1 691 801	1 279 996	1 047 950	1 143 486	1 821 514	2 058 150	1 926 401	1 698 788	1 543 789	1 389 239
Net out/inflow from operations	(32 656)	(61 805)	(37 046)	(29 464)	(58 972)	(36 364)	(21 749)	(45 613)	(12 999)	(12 550)	(57 303)
*Recapitalisation Release	(1 515 000)		177 000	327 000	564 000	338 000	109 000				
Overdue obligations - creditors/SARS/Legacy/restructuring	(130 000)	(350 000)	(466 000)	(376 000)	(227 000)	(259 000)	(219 000)	(182 000)	(142 000)	(142 000)	(142 000)
Non-core asset planned inflow			94 000								
Non-core asset planned inflow						194 000					
Non-core asset planned inflow				174 000							
Non-core asset planned inflow					400 000						
Closing Cash Flow	1 691 801	1 279 996	1 047 950	1 143 486	1 821 514	2 058 150	1 926 401	1 698 788	1 543 789	1 389 239	1 189 935
Total legacy obligations to be paid by 31 March 2024 R2,739m											
*Recapitalisation Release - Funds that is ringfenced and can be released on sale of non core assets											

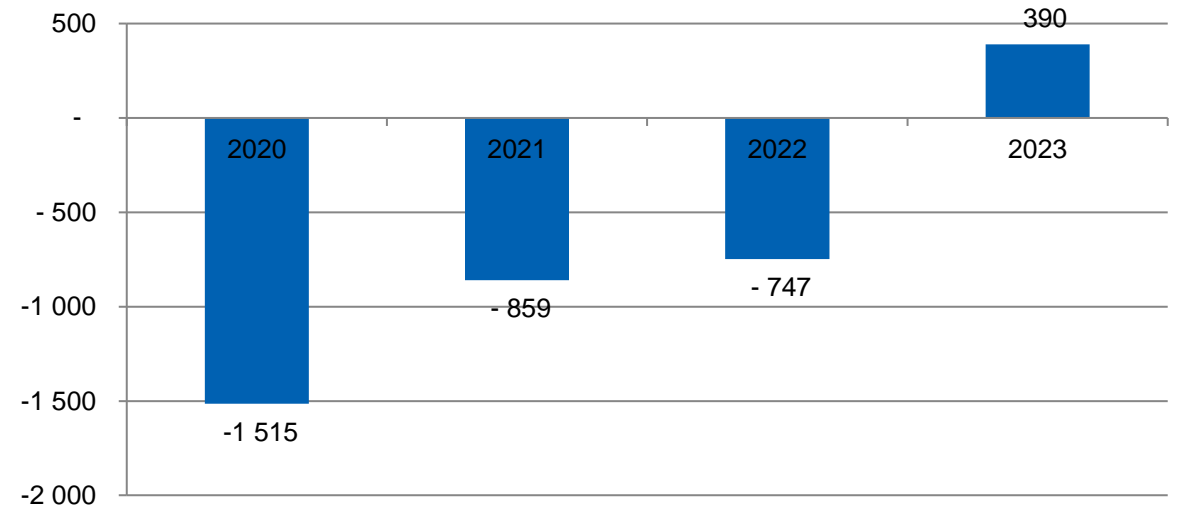


STATUS ON ANNUAL REPORTS

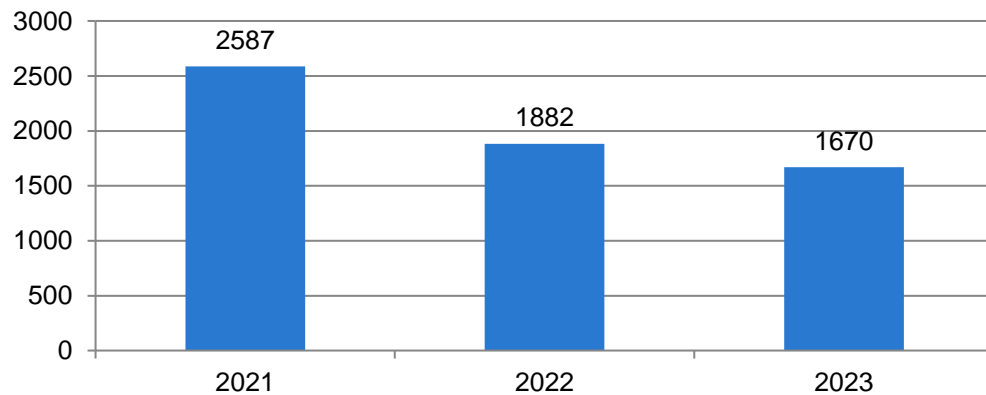
Revenue



Earning before interest and tax (EBIT)



Headcount



- Denel operations have seen a reduction over the last 3 – 5 years.
 - The revenues have declined by 46% with headcount at 1670 as the end of FY2023.
 - Denel has reported preliminary result of R390m EBIT in FY2023 mainly as result of the DMBT funds received.

STATUS ON OUTSTANDING ANNUAL REPORTS

FY2020/21	Submitted 30 November 2022 to AGSA for audit
FY2021/22	Submitted 31 January 2023 to AGSA for audit
FY2022/23	Submitted 31 May 2023 to AGSA for audit

- Timeous submission of annual financial statements for FY2021 and FY2022 was not achieved due to the high turnover of personnel in Denel as a result of non-payment of salaries. Furthermore, AGSA was unable to commence with the audit until some payment was made as it was owed fees from the previous years.
- Upon receipt of payment in March 2023, the AGSA has commenced with the audit of all three years. The date of completion of these audits will be communicated at the end of June 2023 and thereafter will advise on the expected tabling of all three annual reports.



FY2022/2023 – IRREGULAR EXPENDITURE

Irregular Expenditure- R3.28bn

Includes entities liquidated (R1.01bn; 31%) or in process of being liquidated LMT R0.76bn & AEROSTRUCTURES R0.25bn

Prior to FY17/18- R1.54bn *(E&Y Report incomplete due to lack of available documentation for LMT & AEROSTRUCTURES= R0.76bn/49%)*

FY17/18 to FY22/23
R1.74bn

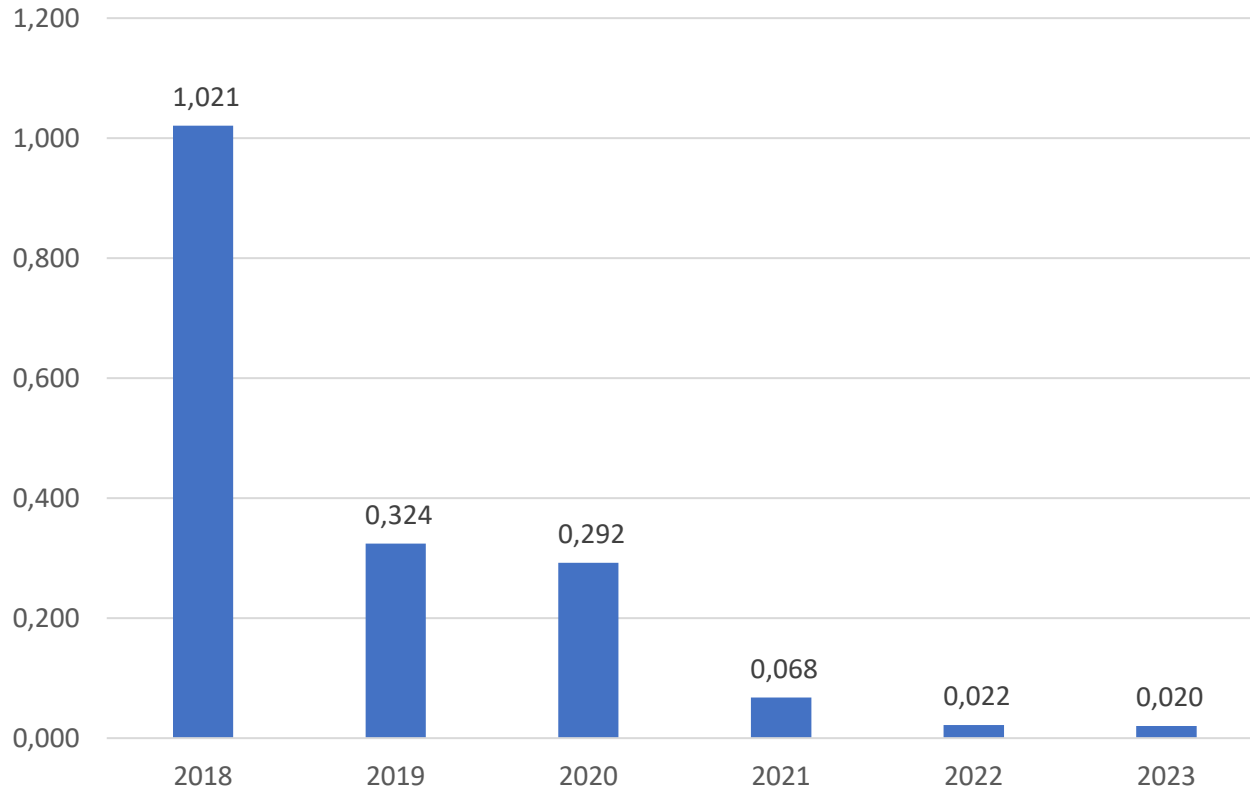
Deviation from Competitive Bidding
R1.80bn (55%)

**Expansions/
Variation of Orders**
R0.43bn (13%)

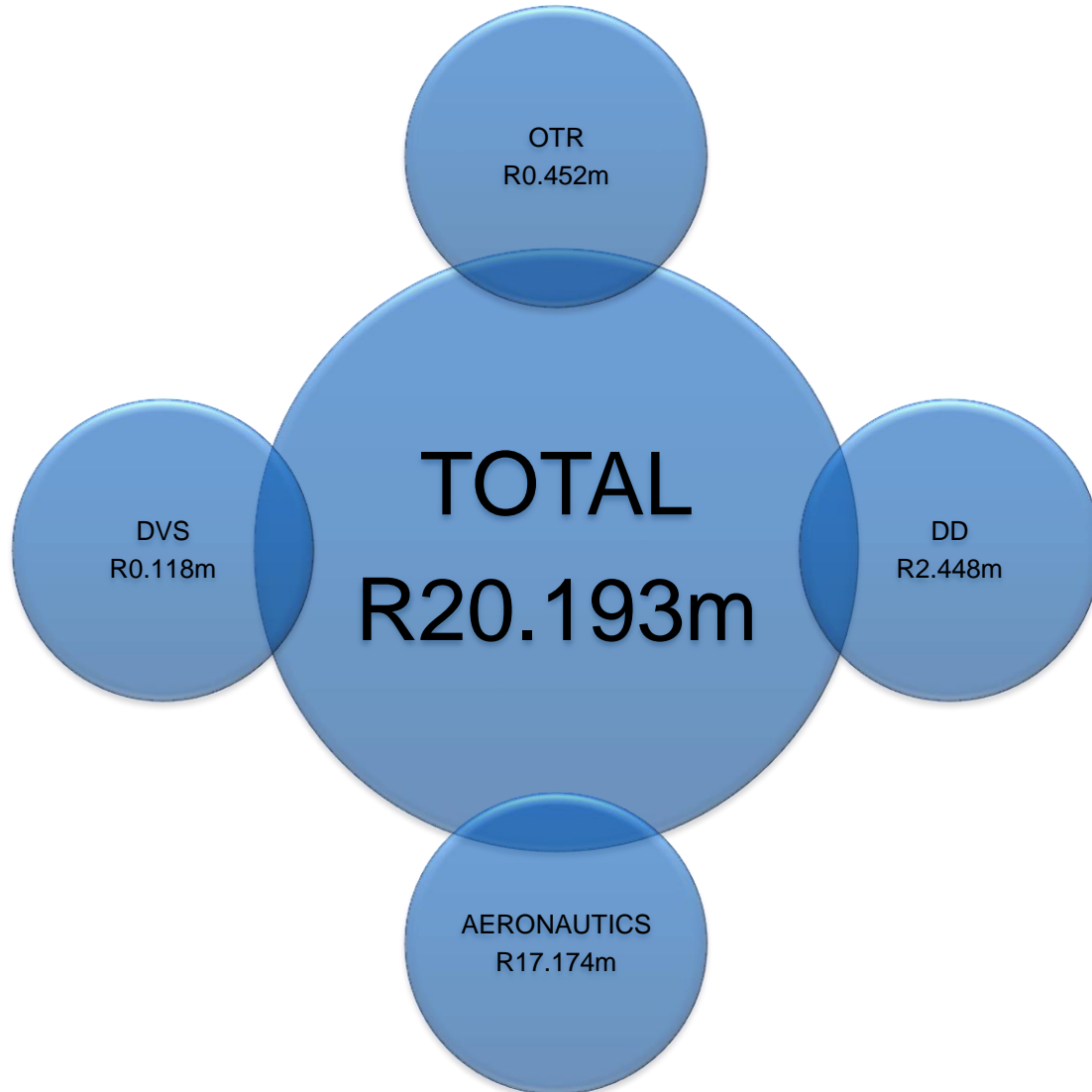
Evaluation criteria not adequately specified or applied
R0.36bn (11%)

Other *(Bids not adequately approved, contracts not signed, declaration of interest, Tax Clearance, AG Findings)*
(R0.69bn (21%))

Irregular Expenditure (Rbn)



- Annual incurred irregular expenditure decreased by 98% since April 2018.
- Investigations will be conducted and to be completed by the end of FY23/24.
- Fit-for-purpose structure as part of the Turnaround strategy includes an Audit & Compliance Unit for Supply Chain tasked to prevent Irregular Expenditure
- Consequence management requires significant improvement as well as processes for reviewing all potential IE.



The main contributor/transgression categories for Irregular Expenditure are attributed to:

1. Deviation from Competitive Bidding Process- **R9.6m**
2. Tax Clearance Certificate not Obtained- **R10.17m**

No fraud, corruption and/or other criminal activities related to these transactions were reported.

Denel is re-establishing its Loss Control Committee to initiate the determination and assessment principles as per the Irregular Expenditure Framework to adequately deal with its Irregular Expenditure portfolio.



INVESTIGATIONS

MATTER	Status update on VR Laser matter
Contract Value	R356m
Offence	Fraud, corruption, PFMA
Summary	<p>Improper or unlawful conduct by Denel officials or employees in respect of the contracting or awarding without procurement process being followed.</p> <p>The appointment of VR Laser was unlawful and invalid in terms of section 2 of the constitution, because the procurement process was not compliant with applicable prescripts regulating public sector procurement.</p>
Action to date	<p>1 disciplined, found guilty and was summarily dismissed</p> <p>Court papers to declare the three contracts concluded between Denel and VR Laser illegal are being handled by the SIU</p>

MATTER	Procurement of Chassis without following due process (ENNE 7)
Contract Value	R69m
Offence	Fraud, corruption, PFMA
Summary	Improper or unlawful conduct by Denel officials or employees in respect of the contracting or awarding through confinement without procurement process being followed.
Action to date	Disciplinary action against current employees completed. None was found guilty.

MATTER	Status update on the establishment of Denel Asia
Contract Value	HKD1,444.11 (Hong Kong Dollars)
Offence	PFMA
Summary	Improper establishment of a foreign entity without following due process.
Action to date	<p>It was established that the entity did not begin trading and has been deregistered in June 2022.</p> <p>GCEO resigned before disciplinary process could be instituted. Delinquency application against the previous board chair has been prepared.</p>

MATTER	Status update on the awarding of Denel Bursaries
Contract Value	R2,8m
Offence	Denel Policy, PFMA
Summary	The awarding of the bursary for the training of pilots to three students and did not follow Denel Policy in doing so.
Action to date	<p>Legal action was taken against four former Denel executives, summons were issued and served on three of the four executives. The attorneys of record in this matter could not serve on one even after services of a tracing agent were used. The other three executives have defended the matter and filed their Pleas. The action against these executives is instituted against them jointly and severally.</p> <p>The SIU has since negotiated a settlement with Mahumapelo’s Attorneys for the repayment of bursary monies allocated Mr Mahumapelo over a period of 36 months. There is, however, no settlement agreement in respect of the other two student beneficiaries.</p> <p>The matter is pending an NPA decision</p>

MATTER	Payment of Technical Advisor – (Chad contract)
Contract Value	USD720,000
Offence	Fraud, PFMA, Corruption
Summary	Payment was made to the Technical Advisor without tangible services being provided.
Action to date	<p>4 employees disciplined, 2 were found guilty with 1 final written warning and 1 written warning</p> <p>The divisional CFO resigned on the eve of the disciplinary process.</p>

MATTER	Intellectual Property arrangements with Barij Dynamics
Contract Value	R328m
Offence	PFMA, fraud, corruption
Summary	Improper transfer of IP to Edge Halcon (Edge is the majority shareholder in Barij Dynamics)
Action to date	1 employee disciplined and dismissed. Possible criminal investigations being conducted by the SIU.

MATTER	Acquisition of Denel Vehicle Systems
Contract Value	R855m
Offence	Governance
Summary	The former executives did not obtain the necessary approvals for the funding of the acquisition.
Action to date	Denel received a legal opinion from senior council which indicated that since the matter has prescribed, Denel will not be able to recover the amounts from the previous executives.

MATTER	Procurement of legal services
Contract Value	R10m
Offence	PFMA
Summary	<p>Improper or unlawful conduct by Denel officials or employees in respect of the contracting or awarding without procurement process being followed.</p> <p>Khampa was not listed on Denel’s legal panel. The GCEO and board chair directed the process without the involvement of the legal department.</p>
Action to date	<p>GCEO resigned before disciplinary process could be instituted. Delinquency application against the previous board chair has been prepared.</p> <p>The matter is further investigated by the SIU.</p>



THANK YOU!

