



PRESENTATION TO PORTFOLIO COMMITTEE ON PUBLIC ENTERPRISES

Mr Zoli Kunene: Chairman: Denel (SOC) Ltd

Executives:

Mr Talib Sadik, Mr Fikile Mhlontlo & Ms Patience Mushungwa

19 October 2011

CONTENTS

- Overview of Denel
- Performance against Shareholder's Compact
- Financial progress since 2005/06
- Financial and Governance: 31 March 2011
- Business Development
- Major Programmes
- Human Resources & Transformation
- Denel's value-add to South Africa
- Critical strategic matters
- Conclusion

DENEL'S MANDATE

In terms of the Shareholders Compact, Denel's key role is to:

- Supply strategic defence capabilities and technology to the SANDF on a commercially viable basis.
- Act as a catalyst for advanced manufacturing in the broader economy.
- Export products to improve revenue.

DENEL PURPOSE AND VISION

Purpose

To provide strategic defence technology, product and service solutions to the South African Defence and Security communities and international customers

Vision

To be the respected South African provider of innovative Defence, Security and related technologies

DENEL PRODUCTS & SERVICES OFFERED TO SANDF, PROMOTED IN OVER 50 COUNTRIES AND UNITED NATIONS

Humanitarian demining services and products

MRO (Maintenance repair and overhaul)

UAVS. (Unmanned Aerial vehicles)



Technical Training

Aerostructures

Engineering services



Munitions and sub components

Land based systems (Artillery, Infantry and Armour systems)



Mine Protected Vehicles

Command and Control

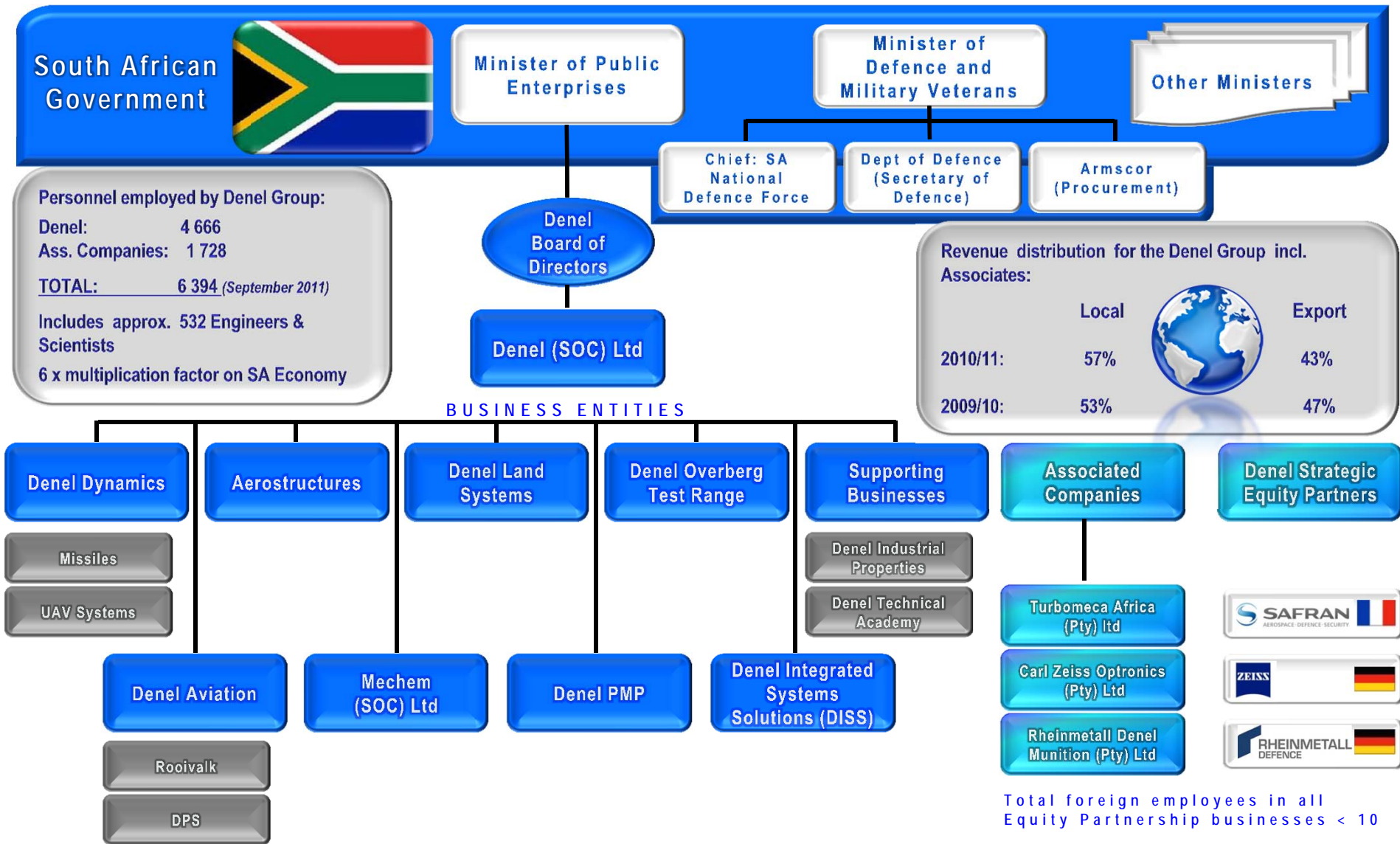
Missiles

Manufactured by 13 business entities, 6 400 direct employees and over 30 000 indirect through multiplier effect, with 10 offices outside SA

DENEL OPERATES IN FOUR INDUSTRIAL CLUSTERS



DENEL GROUP STRUCTURE



Personnel employed by Denel Group:
 Denel: 4 666
 Ass. Companies: 1 728
TOTAL: 6 394 (September 2011)
 Includes approx. 532 Engineers & Scientists
 6 x multiplication factor on SA Economy

Revenue distribution for the Denel Group incl. Associates:

	Local	Export
2010/11:	57%	43%
2009/10:	53%	47%

Total foreign employees in all Equity Partnership businesses < 10

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DENEL ACHIEVES ITS STRATEGIC INTENT IN MOST KPA'S

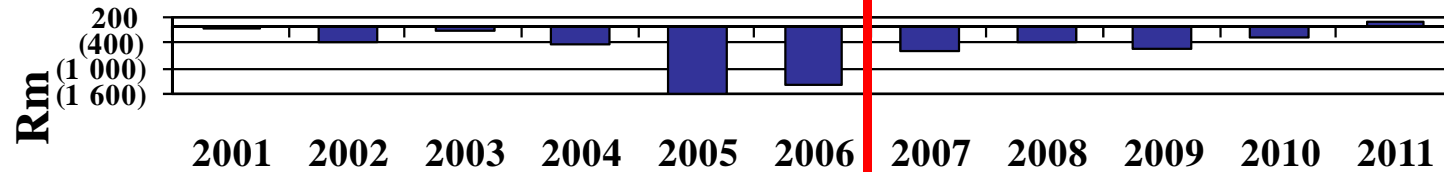
Key performance area	Achieved
Retention of capabilities in areas required by the DoD&MV	Green
Maximise access to local markets	Green
Contracted SANDF/DoD&MV programmes	Green
Promote advanced manufacturing goals of the country	Green
Investment in research and development	Green
Profitability management	Yellow
Reduce debt and gearing	Red
Improve cash management	Green
Healthy sales pipeline	Green
Productivity improvement	Yellow
Optimise operating expenditure	Red
Contribution to economic transformation (including attainment of key supplier development)	Green

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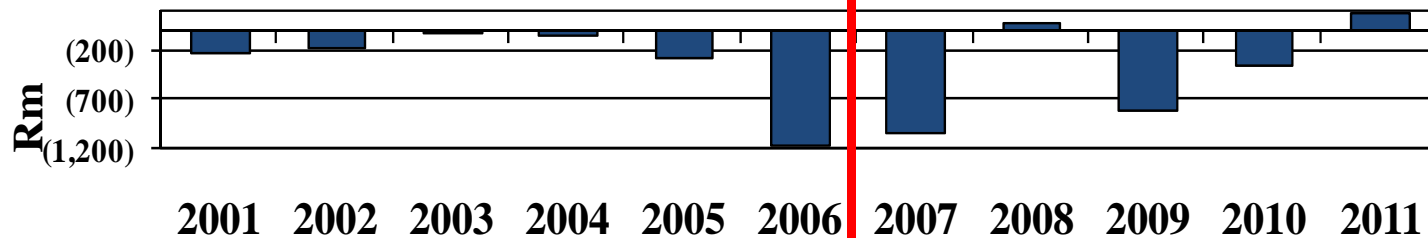
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DENEL CONTINUES TO SHOW PROGRESS TOWARDS SELF-SUSTAINABILITY

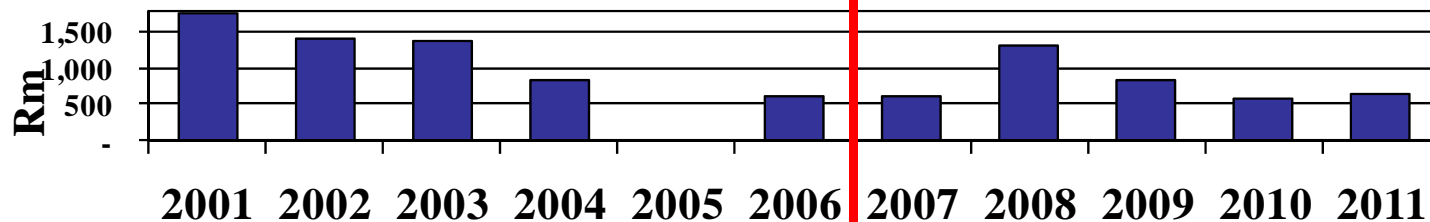
Losses



Cash



Solvency



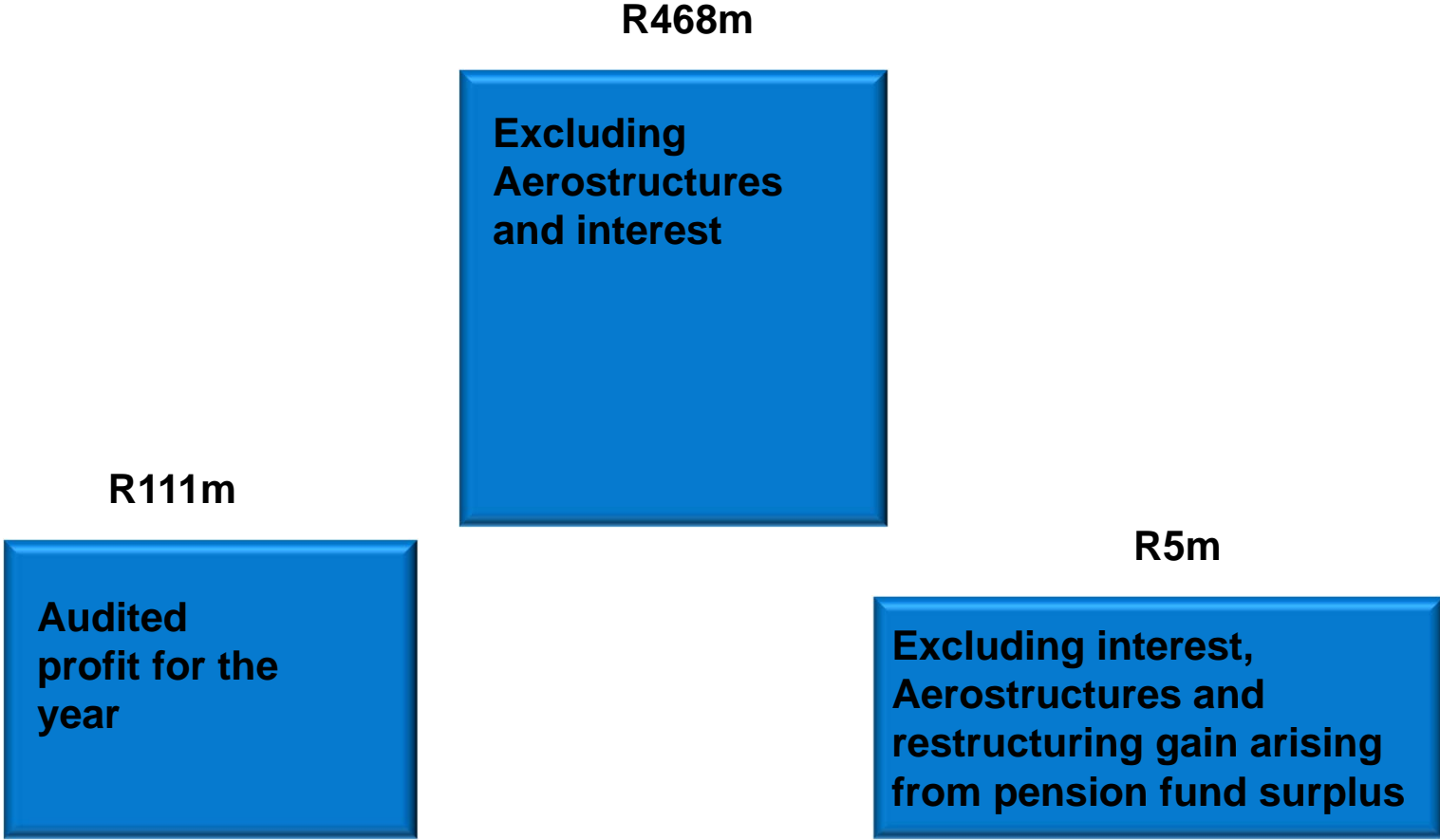
Turnaround strategy introduced



The Group continued to improve on historic losses through:

- Values driven leadership
- Restructuring
- Improved access to sustainable markets
- Operational excellence
- Cost optimisation
- Strengthening governance & compliance

DENEL ACHIEVES A PROFIT OF R111m

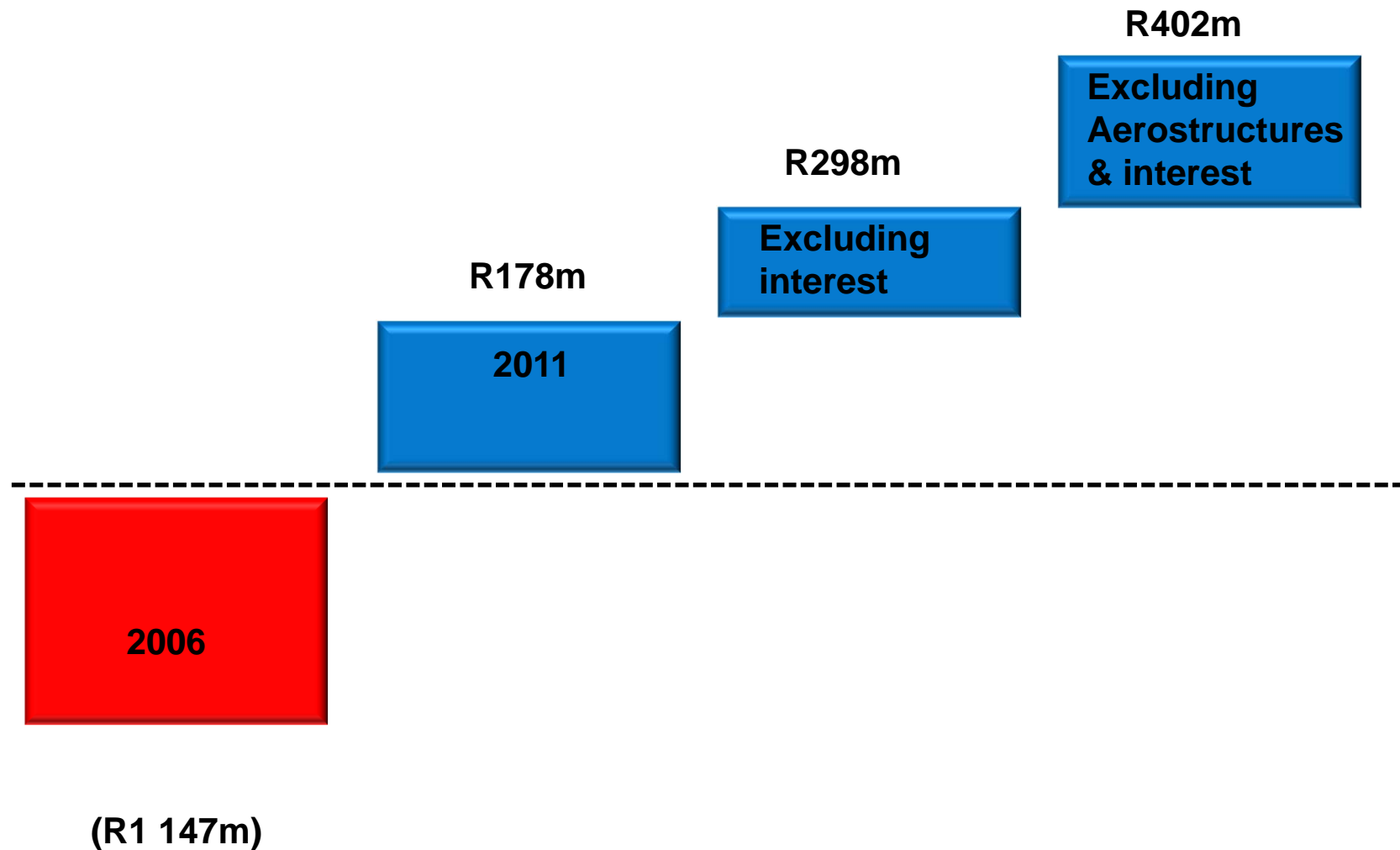


2006

(R1 363m)

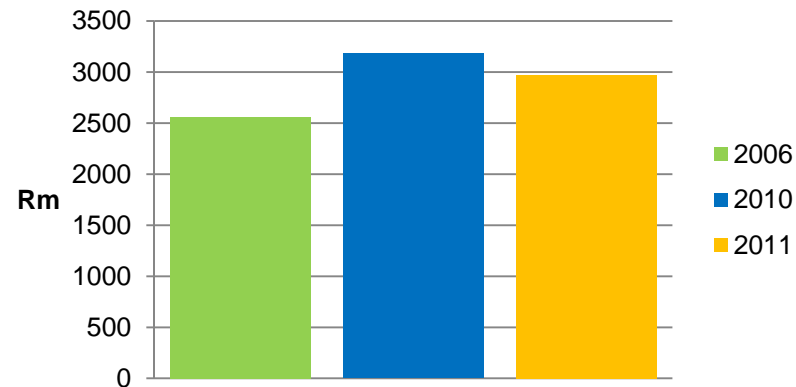


DENEL GENERATES A POSITIVE CASH OF R178m, AN IMPROVEMENT OF R522m FROM (R344m) IN 2010



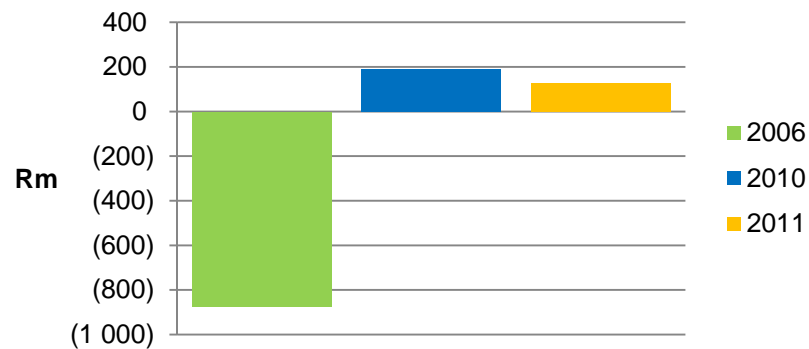
DEFENCE, SECURITY AND CERTIFICATION CLUSTERS NOW SELF SUSTAINABLE

Sales

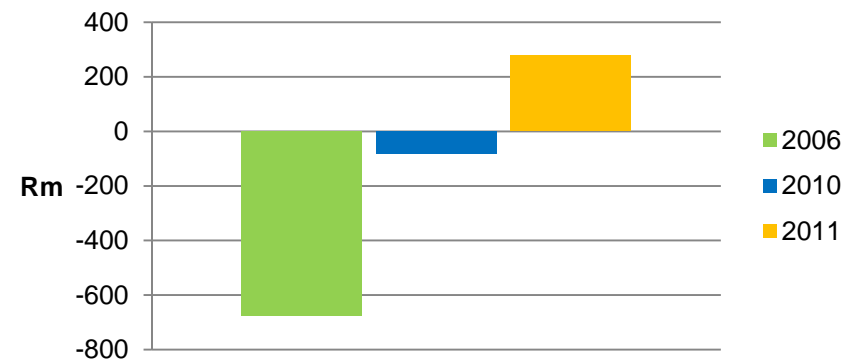


Defence, Security and Certification clusters generates an EBIT of R130m and cash of R278m

EBIT

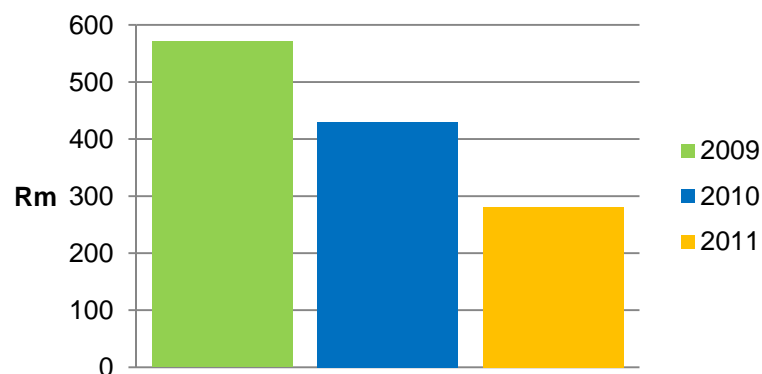


Cash flow

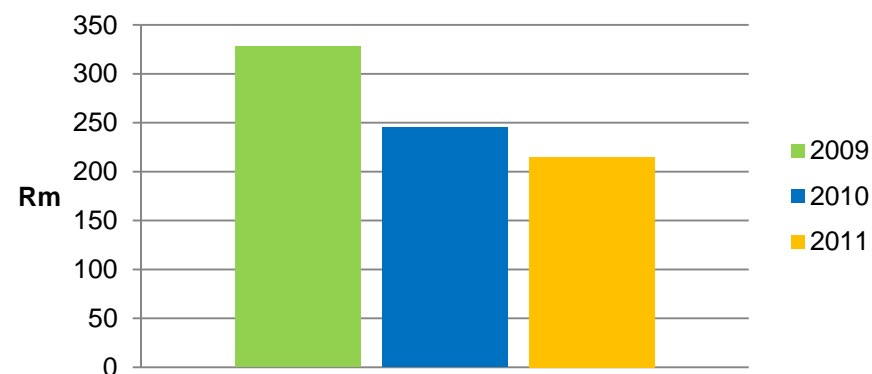


POSITIVE RESULTS ACHIEVED FROM AEROSTRUCTURES TURNAROUND PLAN

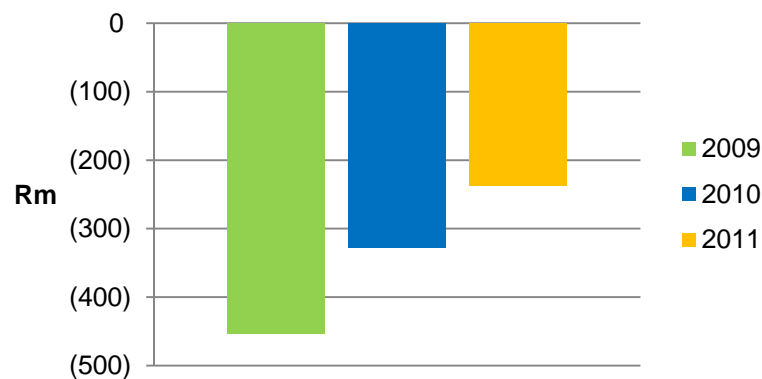
Sales



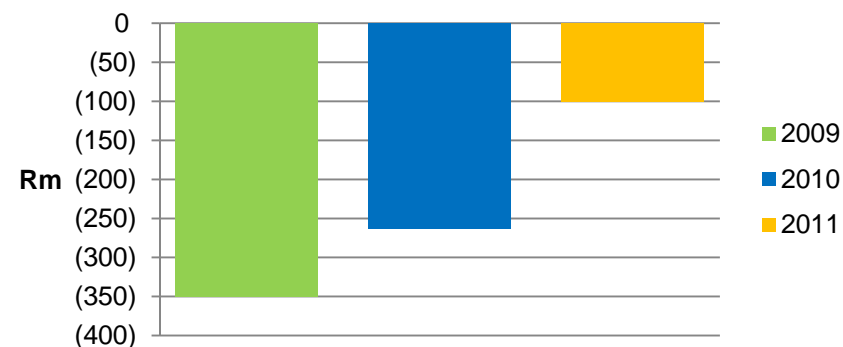
Opex



Net profit/(loss)



Cash flow from operations



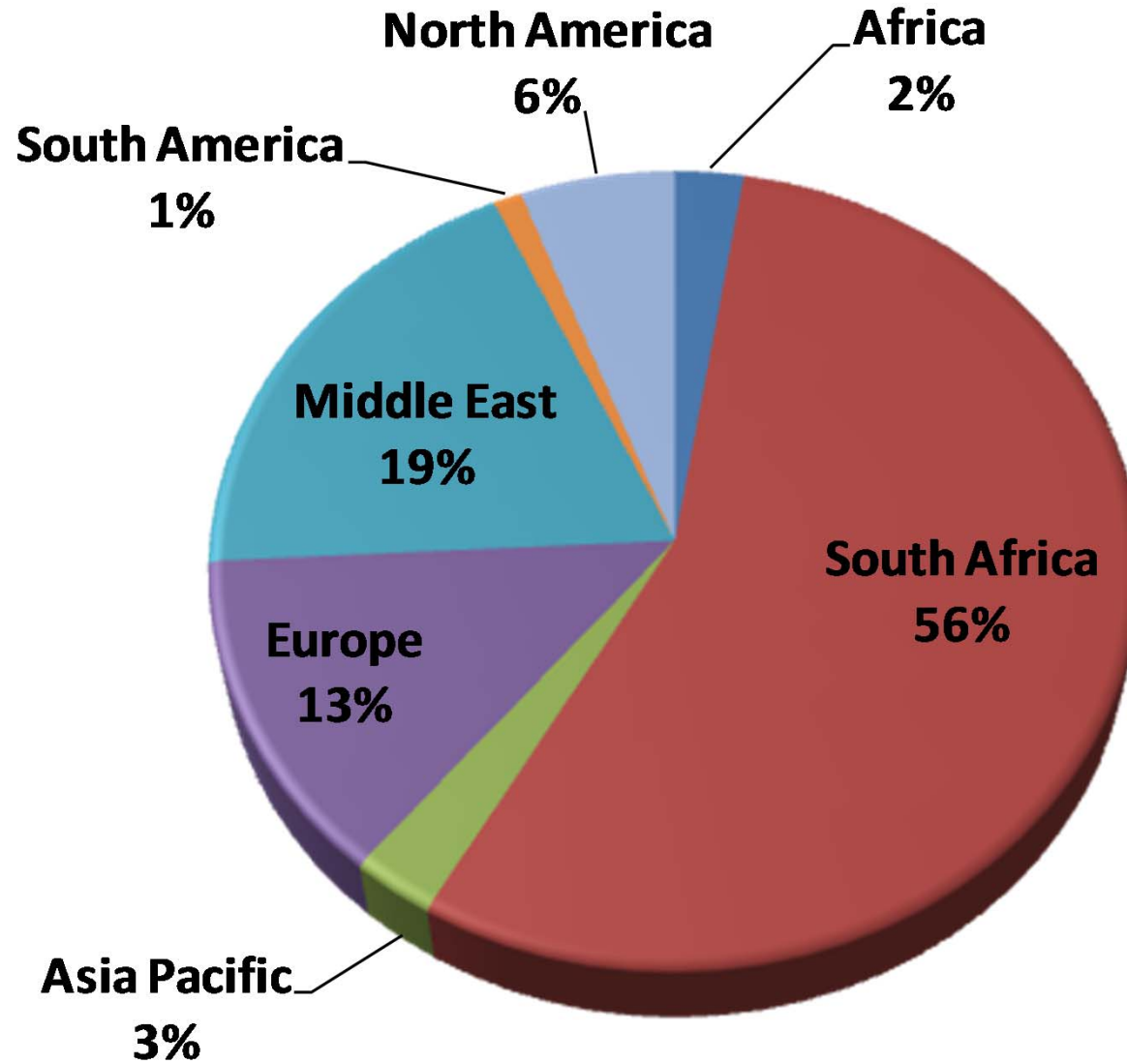
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GROUP INCOME STATEMENT: 31 MARCH 2011

	Group	
	Mar-11 Rm	Mar-10 Rm
Revenue	3 252	3 610
Gross profit	503	578
Gross profit as % of sales	15%	16%
Other income	80	106
Other operating expenses	(897)	(846)
Operating costs as % of sales	(28%)	(23%)
Operating loss	(314)	(162)
Closed Pension Fund surplus	463	-
Share of profit of Associates	115	79
Profit/(loss) before interest and tax (EBIT)	264	(83)
Net interest	(120)	(139)
Income tax expense	(33)	(24)
Net profit/(loss)	111	(246)

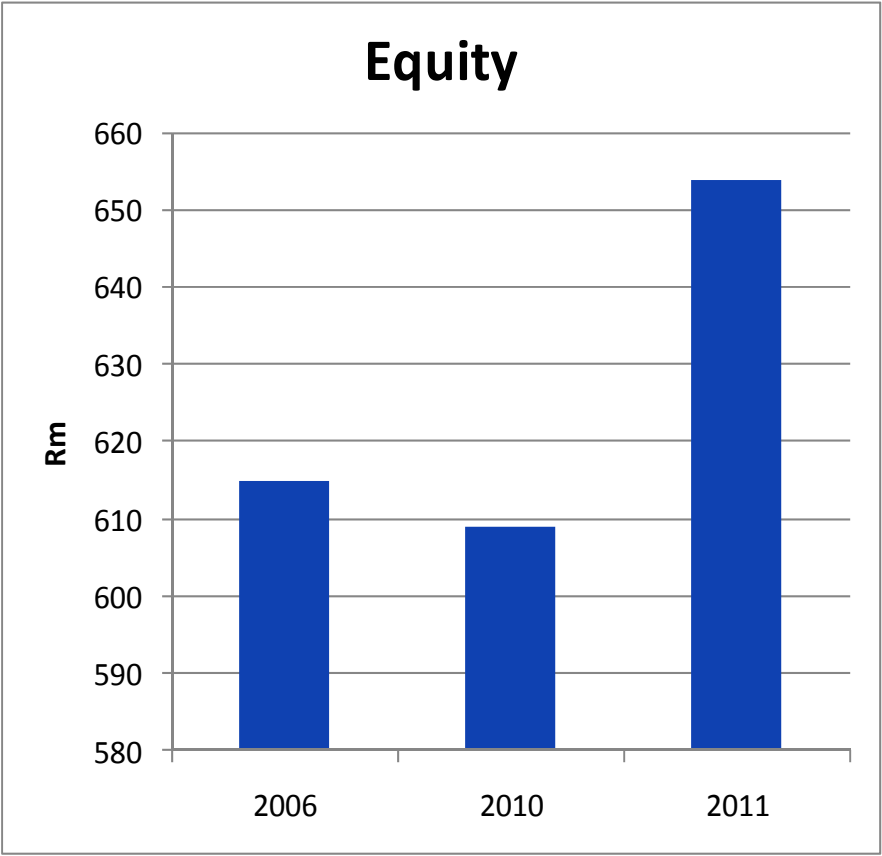
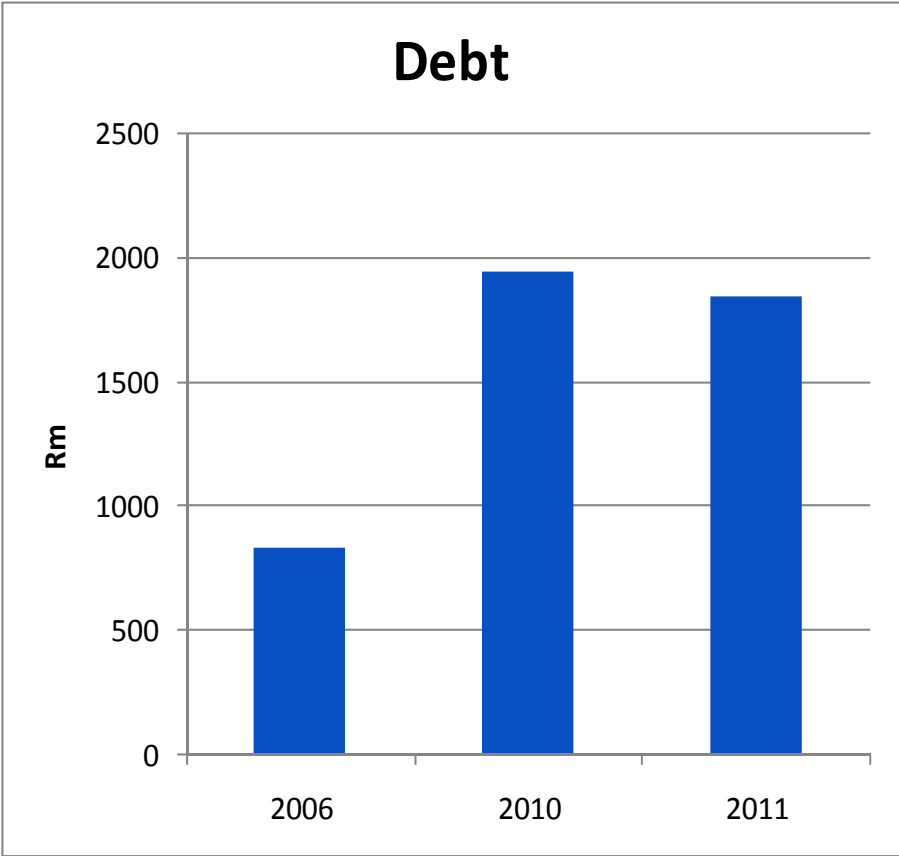
DENEL ACTUAL SALES FOR 2010/11 (INCLUDING ASSOCIATED COMPANIES)



GROUP BALANCE SHEET AS AT 31 MARCH 2011 – IMPROVES FROM PREVIOUS YEAR

	YEAR-END	
	Actual Mar-11 Rm	Actual Mar-10 Rm
Non-current assets	2 110	1 677
Current assets	2 921	3 343
Inventories	570	713
Trade and other debtors	1 326	1 490
Advance payments made	105	102
Cash & cash equivalents	920	1 038
TOTAL ASSETS	5 038	5 020
Total equity	654	609
Non-current liabilities	475	457
Current liabilities	3 909	3 954
Creditors	658	633
Interest bearing borrowings	1 845	1 943
Advance payments received	860	602
TOTAL EQUITY AND LIABILITIES	5 038	5 020

DENEL'S DEBT AND EQUITY LEVELS ARE VERY CONCERNING



GROUP CASH FLOW STATEMENT: POSITIVE CASH GENERATED

	YEAR-END	
	Actual Mar-11 Rm	Actual Mar-10 Rm
Net cash flows from/(used in) operating activities	178	(344)
Net cash flows used in investing activities	(201)	(72)
Net cash flow (before financing activities)	(23)	(416)
Net cash flows (used in)/from financing activities	(203)	904
Net increase/(decrease) in cash	(226)	488
At beginning of the year	1 180	692
At end of the year	954	1 180

DENEL CONSISTENTLY ACHIEVES CLEAN AUDIT

- Clean internal and external audit
- Further strengthening of governance structures
- Complied with local and international codes, laws and regulations
- Sound functioning of Board and Board Sub-committees
- Risk governance processes are in place
 - Fraud prevention and anti-corruption including fraud hotline
 - Ethics policy
 - Compliance processes
- Implementation of King III Code of Corporate Governance
 - Stakeholder management
 - IT governance
 - Sustainability reporting
- No significant concerns regarding the internal control environment
- New Board appointed – effective 7 July 2011
- New Companies Act – performing gap analysis and devising implementation plan

NEED TO STRENGTHEN BALANCE SHEET

- Recapitalised in the past to enable repayment of debt, legacy issues and investments
- Continued losses of Aerostructures (FY10:– R328m; FY09: -R453m)
- Debt / equity ratio concerning with R1.85bn of debt at March 2011
 - Debt trap requires recapitalisation of \pm R2bn
 - Solvency R400m, very low for organization the size of Denel
- Denel is experiencing low funding levels – in the short term, using overdraft facilities
- Pressure on bank facilities, i.t.o additional borrowings and issue of bank guarantees
- Recapitalisation discussions to strengthen balance sheet are underway

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STRATEGIC DRIVERS FOR SUSTAINABLE GROWTH LAUNCHED IN 2011

Secure Revenue Growth

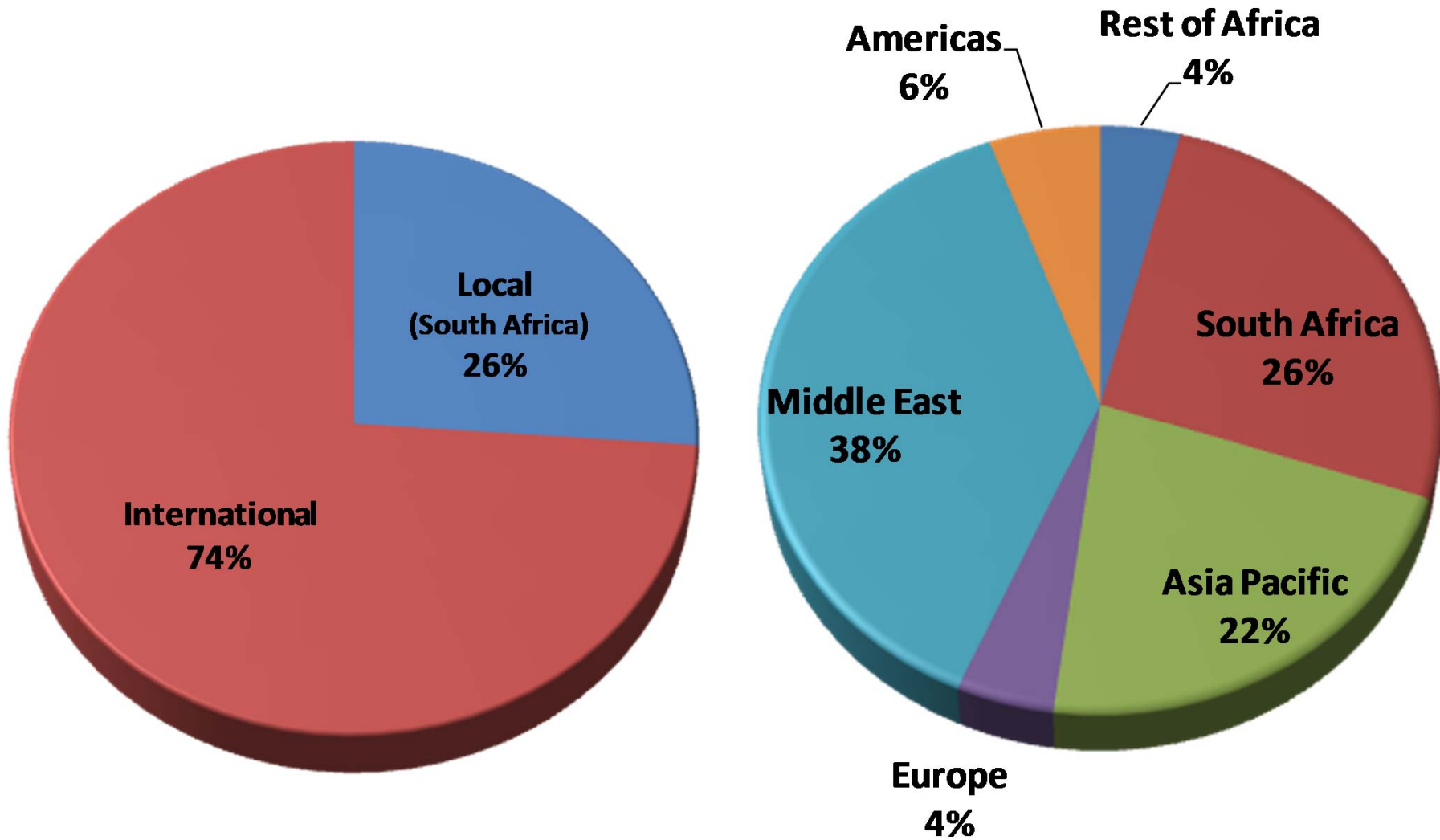
**Foster Productive Relationships with the
Defence & Security Community**

**Enhance Operational Excellence &
Performance**

Optimise Cash and Profitability Management

Be a respected South African company

DENEL OPPORTUNITIES PIPELINE (INCLUDING ASSOCIATED COMPANIES)



MARKETING SUPPORT REQUIRED

- **Challenges include**
 - Competition from developed economies due to home-market defence cuts
 - Alignment between military acquisitions and industrial strategy
 - ✓ International clients seeking indigenous solutions
 - Growing geo-political influences
 - Political unrest in certain countries
 - Lack of growth in domestic spend
- **Support required**
 - Meeting client specifications
 - Strong Balance Sheet
 - Attraction, development and retention of critical skills
 - SANDF support: Development and production orders
 - ✓ UAVS for border protection
 - ✓ A-Darter: Joint programme with Brazil
 - ✓ Hoefyster development order – 8 X 8 Turret order
 - Political and diplomatic support
 - ✓ Bi-Lateral defence cooperation agreements
 - ✓ Proactive promotion of Denel business

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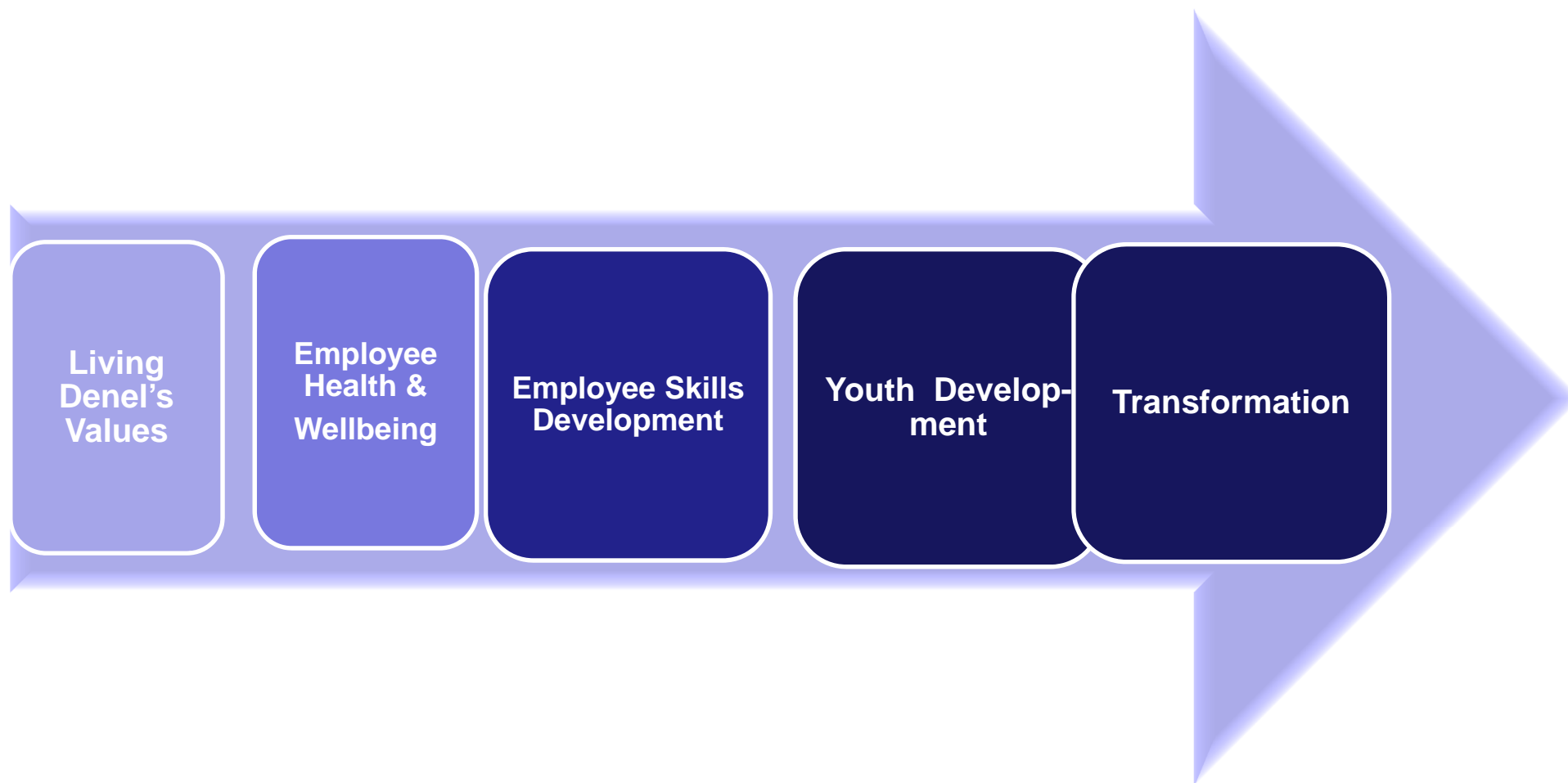
MAJOR PROGRAMMES

Business Entity	Contract
DLS	Project HOEFYSTER - New Generation ICV 8x8 Turret order
DSA	A400M – Wing-to-Fuselage (WFF) / Top Shells (TS)
DISS	GBADS requirements
Denel Dynamics	A-Darter Missile
Denel Aviation	Rooivalk Programme
	Ecuador Cheetah Project
	Oryx Avionics upgrade
Mechem	UN Demining Contracts – Border control freight clearance
Denel UAVs	Seeker 200 - Re-engineering project
	Seeker 400 – Next generation UAV
Carl Zeiss Optronics	Periscope development and support contract

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HUMAN RESOURCES AND TRANSFORMATION



DENEL VALUES ENHANCE POSITIVE BEHAVIOURS & DRIVE GROWTH

DENEL GROUP VALUES (PIICA)

-  **Performance**
WE EMBRACE OPERATIONAL EXCELLENCE.
-  **Integrity**
WE ARE HONEST, TRUTHFUL AND ETHICAL.
-  **Innovation**
WE CREATE SUSTAINABLE INNOVATIVE SOLUTIONS.
-  **Caring**
WE CARE FOR OUR PEOPLE, CUSTOMERS, COMMUNITIES, NATIONS AND THE ENVIRONMENT.
-  **Accountability**
WE TAKE RESPONSIBILITY FOR OUR ACTIONS.



CUSTOMER FOCUS

EFFICIENCY

GROWTH

EMPLOYEE WELLBEING IS CENTRAL TO DENEL'S SUCCESS

- **Wellness Programmes**

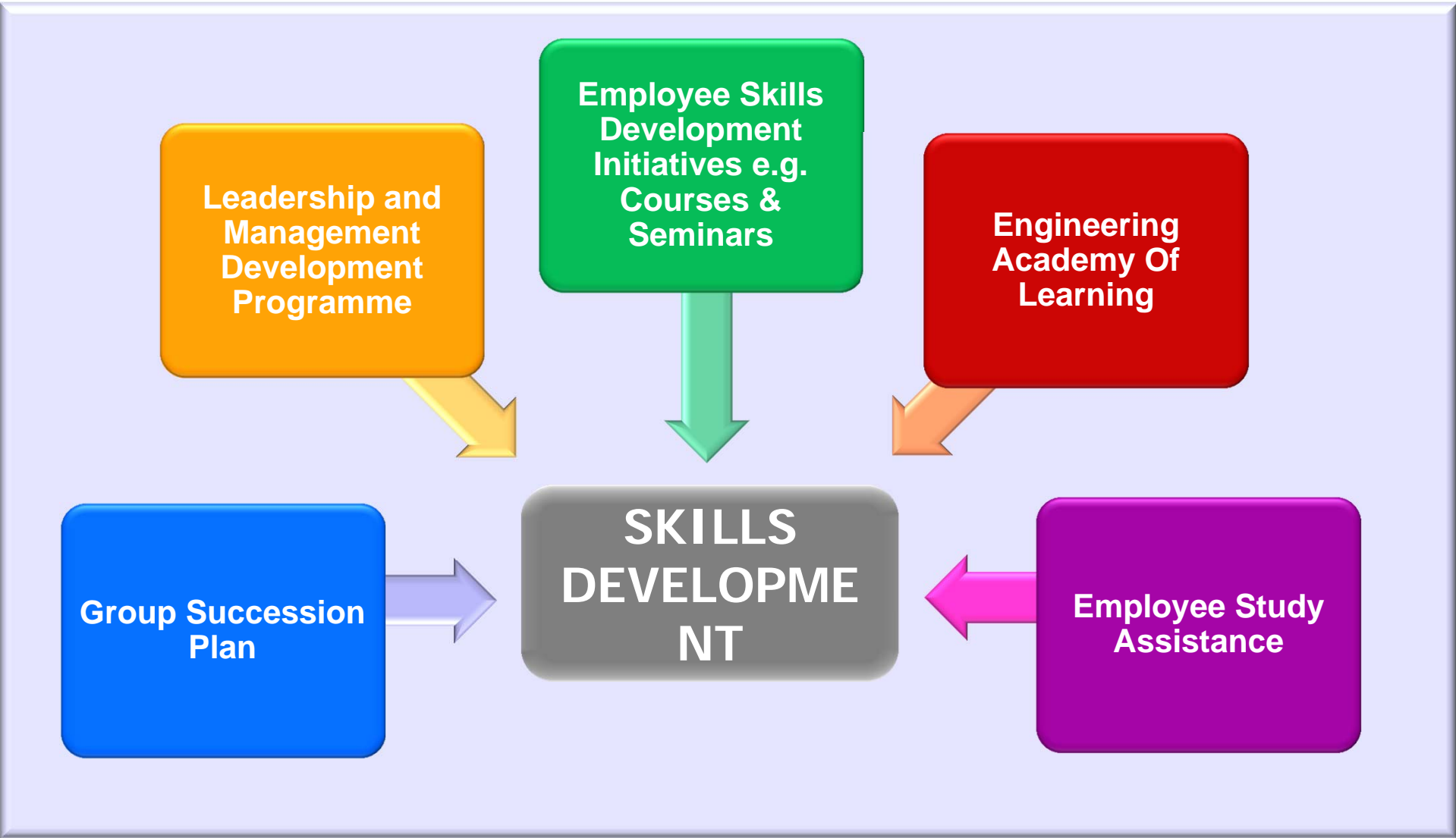
- Cancer and Shavathon days
- Road shows and interactive workshops, dealing with wellness and personal finance
- Wellness days held to check blood pressure, cholesterol, sugar diabetes, etc.
- Most Denel work sites have in-house clinics and healthcare facilities

- **Programmes in support of HIV/AIDS Awareness**

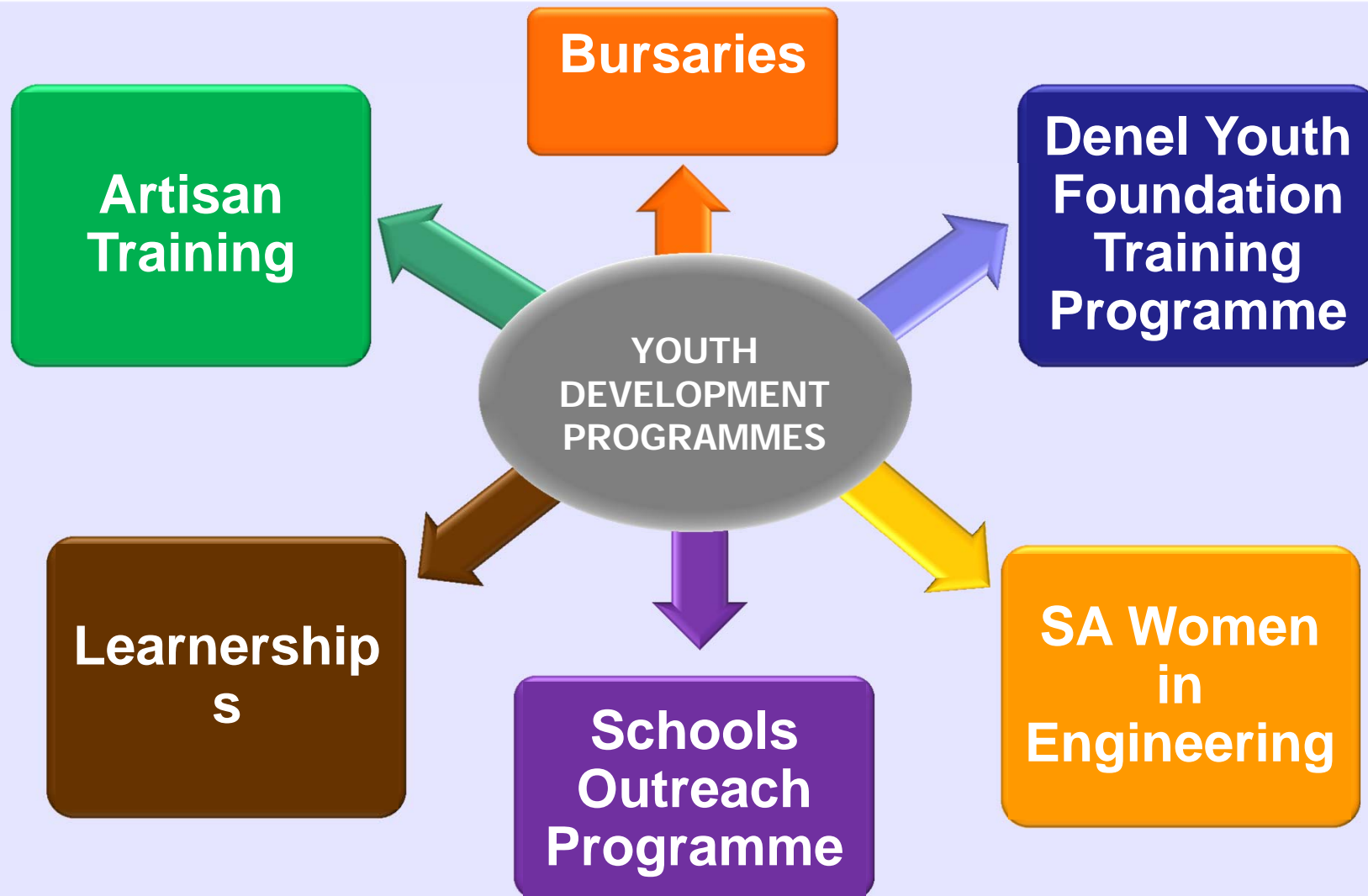
- Awareness sessions held for one week per year
- Posters and banners are displayed during the national HIV/AIDS awareness week
- Industrial theatre artists invited to raise awareness



EMPLOYEE SKILLS DEVELOPMENT INITIATIVES



YOUTH DEVELOPMENT INTERVENTIONS



YOUTH DEVELOPMENT PROGRAMMES OVERVIEW

- To address the challenge of skills shortages, Denel has focused its social investment resources and efforts to the **development of mathematics and science.**
- Rooted firmly on working with learners to either **encourage them to take mathematics and science at high school**, or to provide **bursaries to study engineering and science.**



TRAINING COURSES TO DEVELOP HIGHLY SOUGHT-AFTER SKILLS: DENEL TECHNICAL ACADEMY (DTA)

- **Artisan training**

- Denel's flagship programme is its artisan training academy, within DTA - enrolls learners for different aviation and general apprenticeships.
- Enrolls approximately **300 apprentices per annum**, but with additional funding, could enrol a greater number. Training is offered in the following:
 - ✓ Aircraft related disciplines of avionician, electrician, radiotrician, instrument mechanic, structural worker, mechanic;
 - ✓ Electrician, fitter and turner, machine tool millwright, tool and jig maker, turner and machinist and welding;
- DTA offers SACAA-certified courses and several other advanced courses.



PROACTIVE RESPONSE TO THE SKILLS SHORTAGE IN THE INDUSTRY

- **Denel Youth Foundation Training Programme**

- The Denel Youth Foundation Training Programme (**DYFTP**) - matric bridging facility.
- Programme **costs Denel R5,2m annually**.
- Pro-actively respond to the challenge of lack of skills supply especially in the engineering, science and the technical fields.
- **Learners are sourced from all nine provinces** and are provided with accommodation.
- The programme enrolls about **50 learners per year**.
- Some learners **achieving distinctions** as a result of the programme.



ENSURING ACCESSIBLE SUPPORT FOR LEARNERS

- **Schools outreach programme**

- Other youth development programmes such as the schools outreach programme, where learners from grade 10 to 12 are offered tuition, in some cases by Denel engineers on weekends.
- The programme is currently running in the Gauteng and North-West Provinces with a view that, **should NSF funding be secured, more learners will be assisted.**
- This programme is currently fully **funded by Denel at a direct cost of R1.2m per year.**
- **80 learners were supported in 2010.**

- **Learnerships**

- Denel participates in the **TOPP Programme in 2010/11.**

The TOPP Programme is a South African Institute of Chartered Accountants (SAICA) learnership registered with the FASSET SETA..



INSPIRING THE YOUTH (ESP WOMEN) TO ENTER THE INDUSTRY

- **Women in Engineering**
 - **Partnered with the SA Women in Engineering.**
 - Spearheaded by a group of young female engineers who have a passion of **encouraging female learners to enter the field of engineering, science and technology.**
 - **Denel funds this programme** along with other organisations
- **Collaborations with tertiary institutions**
 - **Denel Dynamics was rated No. 3 by SAGRA** (SA Graduate Recruiters Association)
 - Initiatives have been developed which include visits to universities to improve Denel's ranking as a Group.
 - Denel participated in **Engineering Career Fairs at various Universities, Sci-Bono and Aviation week** and intends to expand to others.

ATTRACTING SKILLS INTO THE INDUSTRY

These programmes target students from various tertiary institutions.

- **Bursaries**

- **Primary tool for bringing young engineers and scientists into the group** to counter the ageing workforce profile.
- About **30 young bursars are welcomed into the programme annually** and are individually mentored and supported.
- **Denel provides the bursars with vacation work and mentors.**
- Over **90% of the bursars that complete their university studies have been employed** in the group.
- Denel's **hands-on approach** ensures bursars are fully supported so that they obtain their qualifications and join the group
- Denel currently has **55 bursars based at various universities** across the country that are studying engineering and another **14 that are pursuing other qualifications.**

BUILDING AND MAINTAINING RELATIONSHIPS WITH TERTIARY INSTITUTIONS

- Denel has built a **close relationship with various engineering faculties at universities for technology programmes.**
- Denel **sponsors postgraduate studies** through this fund the Armscor Ledger Fund. Often, recipients of this funding have opportunities to present their academic papers overseas.
- Denel also continuously **collaborates with engineering faculties at various tertiary institutions** to increase the number of student engineers, so as to increase the general pool of engineering skills in the country.



MONITORING OF TRANSFORMATION PERFORMANCE

- Denel believes in **genuine** Transformation that is sustainable and adds value
 - **Transformation Committees** chaired by the business entity CEO/General Manager
 - **Human Resources and Transformation** weighs 20% of the total CEO's/General Manager's performance contract each year.
- Denel has improved in all aspects of B-BBEE with an overall improvement score of 76% (2010: 69%). **This score makes Denel a 110% B-BBEE contributor and adds value to our suppliers.**
- **Challenges: Levels of diversity (Employment Equity), Skills Development and Preferential Procurement.**
- The group's target was to achieve a Level 4 B-BBEE score but achieved a **Level 3.**

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DENEL'S VALUE-ADD TO SOUTH AFRICA

National Security and Peacekeeping

Contribution

- ❑ RSA strategic military independence & defence stature (AU & G20)
- ❑ Full life-cycle support
- ❑ Customised solutions to meet unique SANDF requirements
- ❑ Internal security and border control
- ❑ MRO, demining and post conflict support
- ❑ FOREX savings – reduced cost of ownership
- ❑ Security of supply

Industrial Strategy, IPAP 2 and NGP

-
- ❑ High tech manufacturing
 - ❑ High value add exports = 2011: R1.3bn, 2010: R1.4bn
 - ❑ Aerospace & advanced materials (Aerostructures)
 - ❑ R&D spend (incl. client funded) = >R1bn for the last 3 years
 - ❑ IP creation and cross leveraging to other industries
 - ❑ Global supply chain integration
 - ❑ Major industrial investment: Aerostructures, TMA, CZO and RDM
 - ❑ Procurement from local industry through supply chain interventions

DENEL'S VALUE-ADD TO SOUTH AFRICA

Employment and Skills Development - NGP

Environment

Contribution

- ❑ Quality/high tech employment
 - ❑ 6400 direct jobs
 - ❑ Supporting over 30 000 technical jobs in industry
 - ❑ Global exposure to technical employees
 - ❑ Artisan training, bursaries, internships, DTA, mentorship and youth training programmes
 - ❑ Developing skills pipeline for advanced engineering, technology development and certified artisan competencies
-
- ❑ ISO 14001 certification and compliance
 - ❑ High tech industry – clean air production
 - ❑ Advanced materials produced by Aerostructures (composites – lighter and stronger materials) for aviation fuel efficiency and CO² reductions
 - ❑ Land rehabilitation programmes

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DENEL FUTURE STATE

- Strengthening Denel's Balance Sheet
 - Repayment of debt
 - Convert opportunity pipeline
 - Successful implementation of new strategic drivers
- Decisions on strategic capabilities required by the DoD and SANDF
 - Strategic Partnerships
 - Minimum multi-year orders for strategic capabilities
- Continuation of turnaround strategy to achieve sustainability of Aerostructures:
 - Successful re-negotiation of Airbus contract
 - Sustainable business case
 - Grow order book
 - Cash and profitability management
 - Skills development and retention
 - IPAP 2 – Sector Development Plan
- Smart partnerships between Denel and key State Agencies
 - Well coordinated political support for exports

DENEL HAS SHOWN SIGNIFICANT PROGRESS TOWARDS SELF-SUSTAINABILITY

HOWEVER, FINANCIAL POSITION NEEDS TO BE STRENGTHENED TO DRIVE GROWTH:

- Equity position of R654m is likely to be eroded in about two years
- Denel is a high working capital investment company and requires on-going funding and support
- Current bank facilities of R5bn needs to be increased, taking into account new orders of R10bn
- Debt position is R1.85bn before taking into account Aerostructures funding
- Urgent need to have the balance sheet strengthened

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CONCLUSION

- Denel on path to self sustainability and profitability
- Strengthening balance sheet
 - Significant order pipeline
 - Growing order book
- Developing and growing talent in South Africa
- Introducing high performance culture
 - Achieved 91% of technical milestones on DoD orders
 - International accreditations maintained
- Strengthening risk management and compliance
 - Clean internal and clean external audit

THANK YOU