



Analysis of Denel's Annual Report

1. Auditor General Findings

Financial Health

Without qualifying our opinion, we draw attention to the fact although the group earned a total comprehensive profit of R41m (2010/11: R111m), there are conditions and other matters that are set forth in the directors report on pages 113 to 120, which indicates the existence of material uncertainties, which may cause doubt about the group's ability to continue as a going concern.

Matters relate to the following:

- Weak balance sheet – DPE together with National Treasury are exploring various sustainable funding mechanisms for Denel.
- Denel is cognizant of the fact that a complete turnaround of the group depends on funding and new revenue streams, including improvement of operational excellence, efficiency and cost structure.
- These issues include the improvement in contracting and risk management, as well as efficiency and cost optimization across all business units.
- The ability of the group to continue as a going concern in the long-term is dependent upon:
 - The successful implementation of business strategy and the recommendations of the cabinet-appointment task team, which is expected to restore the group to profitability on sustainable basis.
 - The ability of the shareholder to support the group financially.
 - The receipt of the R700 million recapitalisation plus rolling over and issuing of the government guarantees of R1, 85 billion, as may be appropriate.
- Should the interventions referred to above be unable to address the profitability and liquidity issues, the group may be unable to realize its assess and discharge its liabilities in the normal course of business.

2. Implications for Denel

- Denel need improvements in their business level strategy, these improvements will be brought about a turnaround strategy.
- Component critical for turnaround strategy are good corporate governance, stability of leadership, financial strategy, repositioning in line with industry with trade mandates such as participation in the BRICS economy.
- The current components of turnaround should be made available for discussion.
- Denel Aerostructures continues to make losses. The company needs special focus.

3. Committee Interaction with Denel Issues Raised

The Committee made the following observations:

- There is a high turnover rate in the entity and there is a need for a retention strategy;

- Not enough effort is made to recruit and support rural youth. There is a need to disburse bursaries for mathematics(maths) and science training;
- There is a low representation of blacks and women in the technical fields and management structure;
- There is a high level of absenteeism and lack of commitment among some board members in terms of meeting attendance;
- Denel only support North West and Gauteng learners in terms of Maths and Science, and there is a need to expand the programme to other provinces;
- National Treasury has not yet released R700 million, recapitalisation for Denel. This had an adverse effect on the performance of the entity.

The Committee recommended that the **Minister of Public Enterprises** should ensure that:

- Denel tables a progress report in the first quarter of 2013 on measures taken to address non-achievement of certain Key Performance Areas (KPA's).
- Denel forwards a detailed report on skills development interventions, profile of beneficiaries and plans to support rural areas and other provinces in maths and science.
- Denel makes a deliberate effort to recruit and support rural and disadvantaged schools.

4. Supplementing Skills in the SA Air Force

- The SAAF has since the 1980s required specialized maintenance services, and experienced difficulty in retaining these skills.
- The SAAF contracted the services of the external service provider (AMG/Armcor/Denel) to ensure that readiness and flight safety is not compromised.
- With the inception of the PFMA in 1999 all DOD contracts had to be re-negotiated to ensure compliance with procurement prescripts.
- The AMG contract was however not considered because it was operated by Atlas, a subsidiary of Armcor.
- The contract was open ended and a cost/benefit analysis was not done since 1986.
- After the new regime it was found that the contract is not compliant with the PFMA and the contract has been reviewed by the auditor general.
- Recommendations were made that the contract is terminated.

5. Implications for Denel

- The termination of the contract will have unintended consequences towards staff mostly engineering and technical skills will be lost in the Aeronautical Industry.
- Implications will also have consequences towards business strategy and Denel's operations.
- What are mitigating factors that Denel has in place in the eventuality that the contract is terminated?

5. Implications of the State of Nations for Denel

- Denel has a responsibility towards ensuring that B-BBEE targets are met:
 - **Employment Equity** – getting blacks, youth and women within the right levels of management.
 - **Skills Development** – within and outside the organisation.
 - **Preferential Procurement** – development of black businesses and industrialists, and payment of suppliers within 30 days.

- **Enterprise Development** – Operationalise supplier development programmes within the Business Strategy and SMME Development.
- **Socio-Economic Development** – Invest in socio-economic development programmes in communities where the company is doing business. Strengthen and enhance the company's reach in terms of development of communities..