



# **Denel Annual Report Presentation to the Portfolio Committee on Public Enterprises**

**24 October 2007**



**Global supplier  
of world-class products**

# Agenda



- **Background**
- **Strategy Update**
- **Business Unit Status**
- **Year-End Results**
- **Order Pipeline and General Progress**
- **Annual Report**
- **Conclusion**



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# Denel looks to be in a financial hellhole

## Denel shoots itself

The Indian government's cancellation of a contract for our country's state arms manufacturer Denel to supply it with 400 anti-matériel rifles (AMRs) is a costly embarrassment to South Africa.

essentially accuses Denel of corruption, the precise circumstances have not been disclosed. Some Indian media are speculating that it has been caught in the crossfire of domestic score-settling. Denel itself has firmly denied any wrongdoing and says it has not yet been

of the decision. It was relatively small – worth about R50 million – but the real danger is that it has also suspended, and may cancel, other Denel contracts worth

to discontinue the very existence of the company. It has already cost the jobs of about 100 employees and a leading MP. Now another

Arms

## Denel more than R1,6bn in the red

BY JANINE STEPHEN  
Political Bureau

Continued from Page One

to ensure it retained its intellectual property rights. In the next few months, Denel would be forced to quit some of its businesses,

### Sunday Times

#### R5bn lifeline to Denel wrong: DA

Thursday October 20, 2005 11:47 - (SA)

South Africa  
oppose the  
rand lifeline

In a statement  
enterprises  
during which  
DA spokes

"The path to  
non-core as

Enterprises and management at Denel address the situation, the bloated parastatal risks becoming a permanent drain on the fiscus."

## Denel loses millions, staff cuts expected

Denel made a loss of between R850-million and R1,6-billion in the past financial year and appears set to slash its products and staff, MPs heard yesterday.

The loss included R64-million in performance guarantees that were called back by India following its investigation into an arms deal with South Africa.

The State-owned arms manufacturer also expects to make a R700-million loss for the current financial year and will be looking

ing to government to keep it afloat.

Denel CEO Shaun Liebenberg yesterday told Parliament that the company was "under immense pressure" and had come "close to insolvency" several times.

Liebenberg presented the figures to a joint sitting of Parliament's committee on public enterprises and the National Council of Provinces select committee on labour and public enterprises. Although Denel has this year received a "cash injection" to

tide them over, Liebenberg said the company has approached the National Treasury for a complete recapitalisation.

It also appears definite that Denel will cut down on its range of products and slash the number of staff. Liebenberg said the company hoped to dispose of 80% on non-core businesses. There was also not enough work for the 10 200 Denel employees, he said. – Janine Stephen

See Business Report

# Swedish lifeline for Denel

Saab venture shows term future of our aerospace in- offset obligations totalling \$8,7bn

**SAKE-BEELD** (Business) – front page 19 - Friday, 20 October 2006

## DENEL SHIP'S BOW AIMING FOR PROFIT WATERS AGAIN

**Antoinette Slabbert** – Denel's new management team has the bankrupt ship afloat again and slowly but steadily steering it to safety

### BUSINESS REPORT

**Denel nets R400m from asset sales**

July 26, 2006



By Mzwandile Faniso

Johannesburg - Denel has completed the sale of its non-core businesses and Shaun Liebenberg, the chief executive, said yesterday that the selling state-owned company would retain more than R400 million from the sales.

### MAIL AND GUARDIAN

## 'Firm support' for Denel

15 February 2006 03:32 - ONLINE

The anticipated expenditure outcome for 2005/06 of R419-billion took into account the anticipated and unavoidable expenditure of R2-billion to the state arms company Denelcor, R2,7-billion to the Road Accident Fund, reported South African Finance Minister Mcebisi Jonas.

## Denel sets its sights on Europe

By KIM HELFRICH

NEW Denel chief executive Shaun Liebenberg is ringing the changes in his efforts to turn the troubled defence industry supplier into a profitable parastatal.

In the past Malaysia and South America have been the objects of Denel's marketing efforts, but this is changing with the focus now on Europe.

With an eye on global partnerships, Denel will be showing niche defence and aerospace equipment at DSEI 2006, the premier defence exhibition in Europe this week.

The locally designed and manufactured LCT-30 turret will be fitted to a Finnish Patria vehicle.

Denel will also show its Eagle Eye target location binoculars, and its pilot helmet sighting and tracking system.

Infrared imaging cameras and the Goshawk and LEO surveillance equipment, used in about 20 countries worldwide, will also be on display. [kimh@citizen.co.za](mailto:kimh@citizen.co.za)

## Saab, Denel Lay Big Plans for New Joint Venture

By BROOKS TIGNER,  
SATENÄS, Sweden



Far beyond aerostructures, however, lie the possibilities for Saab and Denel to tackle other aircraft projects.

Search

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## Denel gets Eurocopter accreditation

11 May 2007

Eurocopter formally certified Denel Aviation, a subsidiary of Denel (Pty) Ltd., as an Eurocopter

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(2 items

## BUSINESSDAY

NEWS WORTH KNOWING

Tuesday, 14 August 2007

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Posted to the web on: 11 July 2007

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### State backing earns Denel ratings boost from Fitch

Khulu Phasiwe

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Arts & Leisure

Trade and Industry Correspondent

RATING agency Fitch Ratings yesterday affirmed defence parastatal Denel's national ratings at long-term AA(zaf), stable outlook and short-term F1+(z)

Denel's senior unsecured rand-denominated debt at AA(zaf).

"The affirmation relies heavily on Fitch shareholder, the department of public returning Denel to profitability in the

It said the defence department also supported the global aerospace and defence systems supplier's recovery.

## CIVIL COMMERCIAL AVIATION DAY

DECEMBER 2006

CENTURION NEWS 3

# Denel now supplies airbus tail 'structures'

RIA LOGGEMBERG

Irene-based defence company, Denel, recently announced that Airbus Military in Germany awarded it a contract to build part of the internal skeleton of the new Airbus A400M military transport aircraft.

Denel will design and manufacture the ribs, spars and sword - literally the "bones" that form the skeleton structure of the aircraft's vertical tailplane (VTP).

The VTP spars are approximately 7 meters in length, the longest single monolithic carbon composite structure yet to be manufactured at Denel's Aerostructures facility near O.R. Tambo International Airport.

This is the latest in several orders for design engineering, manufacturing and supply of components awarded to Denel since

South Africa became an industrial partner in the A400M programme in April 2005.

Earlier this year Denel delivered the first set of A400M fuselage top-shells, part of the "roof" structure of the aircraft. These pieces have already been built into the fuselage of the first A400M currently being assembled in Bremen, Germany.

Another large A400M section that Denel is manufacturing is the wing-to-fuselage fairing. This precision-engineered structure is one of the most important aerodynamic elements of the aircraft, ensuring a smooth, streamlined and uninterrupted flow of air around the area where the wings and aircraft body are joined.

The A400M, the world's most modern military transport aircraft of which 180 examples were ordered by seven European NATO nations, will first fly in 2008. The South

African Air Force (SAAF) will get eight of these airlifters that will enable air forces around the world to carry out humanitarian and peacekeeping activities.



Graphics supplied by Denel

Centurion News reported in December 2005 on the development of the A400M by Denel and Aerosud Holdings in Pierre van Ryneveld Park as partners. According to a spokesperson from Aerosud Holdings at that stage, the A400M can be classified in the same group as the Lockheed C-130 Hercules.

Mr Sam Basch, Group Manager: Corporate Communication of Denel told Centurion News, "By participating in the A400M programme Denel and Centurion-based Aerosud will contribute significantly to South Africa's aerospace industry capability, especially in areas like niche engineering, design, manufacturing and development services for aircraft systems.

SAAB of Sweden recently acquired a 20% equity holding in Denel's Aerostructures business.

BUSINESS DAY, p.17 (front page Companies) - Thursday, April 26, 2007

## Denel scoops missile deal with Brazilians

Abdul Milazi

Trade and Industry Editor

LOCAL arms manufacturer Denel has scooped a R1bn air-to-air missile joint-venture contract with the Brazilian air force.

This is seen as the coming to fruition of the south-south co-operation agreement recently initiated by President Thabo Mbeki and his Brazilian counterpart, Luiz Inácio Lula da Silva.

The contract, signed by Armscor on behalf of the South African National Defence Force (SANDF) on Friday last week, will see the start of the latest generation of the A-Darter air-to-air missile programme. It will be developed by and for both the SANDF and the Brazilian air force.

Sam Basch, defence analyst at Denel, says the 2m-long missile has been under development in SA for more than two years. It has been tested using a motor from a smaller antitank missile, in what is called a "boosted launch".

It would be manufactured locally, using parts from SA and Brazil, both of which have missile capabilities. The logistics as to which specific parts would be sourced from which country are still being negotiated.

According to Denel spokesman Joe Makhafola, the development of the

skills, training, and technology between the two countries.

"Already, 10 Brazilian air force members are working on the programme at the Denel Dynamics plant and they will be supplemented by a further 20 people from Brazilian defence companies," said Makhafola.

He said the A-Darter missile development, which will be conducted by Denel Dynamics, was important to the aerospace cluster in equipping the aircraft of both air forces.

"The A-Darter missile will guarantee a credible deterrent for the South African Air Force and will maintain and expand the local capabilities in this field over the next 15 years," said Makhafola.

He said future missile export contracts, flowing from this programme, were expected to add another R2bn over the 15-year period, adding to the sustainability and viability of Denel Dynamics.

He said that about 200 engineers would be required over the duration of the contract.

"Already there are signs that increasing numbers of young engineers are being attracted to Denel, specifically to be part of leading-edge technological projects such as that offered by the A-Darter development contract," said Makhafola.

The market value of the international deal at about

# Denel teams up with Carl Zeiss

By **KIM HELFRICH**  
THE partnership between German optical giant Zeiss and Denel Optronics has ensured the future of South African military technology

## Denel lands R8bn SANDF contract for new-generation vehicle

By: **Mariaan Olivier**  
Published: 18 May 07 - 9:05 in Engineering News.

State-owned arms maker Denel has landed an R8-billion Defence Force (SANDF) to develop the South African A vehicle.

The contract, dubbed Project Hoefyster, is the largest c 16-year history.

"This Armscor contract puts Denel Land Systems on the **Liebenberg** said, adding that the deal signalled the confidence in the local defence industry's capabilities.

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**BUSINESS**

# Denel gets German arm in deal

*European investor's stake a bid to boost business for ailing defence parastatal*

THE rest of the world has gained much from the loss of arms to Germany.

Denel is a former South African Police Service training area.

Given that their systems were highly specialised, Rossouw said they preferred to implement solutions on behalf of customers rather than for

band. The system can also be used for parking suspect vehicles.

a former South African Police Service training area.

Given that their systems were highly specialised, Rossouw said they preferred to implement solutions on behalf of customers rather than for

## Denel poised for 105 mm artillery system contract

Denel Land Systems is expected to be awarded a contract from Armscor, the South African defence procurement agency, for development of a new 105 mm artillery system to meet the requirements of the South African Army.

The new weapon, dubbed the Advanced Multi-Role Light Artillery Gun Capability (AMLAGC), will be based on an existing 105 mm artillery system, but will have a significant increase in capabilities.

Key requirements are that it must

be durable, dependable and be easy to operate, have a range of between 24 km and 30 km and use a family of ballistically compatible ammunition.

Armscor previously partly funded development of the Denel 105 mm Light Experimental Ordnance (LEO) together with a suite of associated advanced ammunition. A complete LEO 105 mm system was unveiled in 2001 although this was preceded by a ballistic testbed. The first variant weighed about 3,700 kg but it is expected that this will be reduced to about 2,500 kg.

The LEO will form the basis of the new AMLAGC 105 mm system, which will also include its family of ammunition, onboard fire-control systems plus logistics and training.

Phase I of the AMLAGC programme is expected to run to 2008 and include

The first example of the LEO 105 mm artillery system deployed in the firing position

DENEL LANDSYS



**BUSINESS**

# Landmine-tracking outfit may boost 2010 security

MALOSE MONAMA

band. The system can also be used for parking suspect vehicles.

a former South African Police Service training area.

Given that their systems were highly specialised, Rossouw said they preferred to implement solutions on behalf of customers rather than for

**ENGINEERING NEWS ONLINE**

### LOCAL SUPPLIERS

## Denel commits to 70% local content for R8bn Hoefyster contract

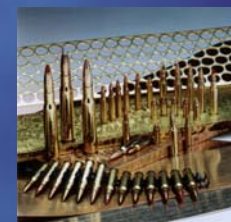
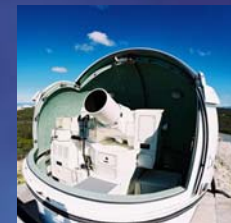
By: **Mariaan Olivier**

Published: 18 May 07 - 10:46

The State-owned arms manufacturer, Denel, has earmarked more than 70%, or R5,6-billion, of its R8-billion Project Hoefyster, for local suppliers, Denel spokesperson **Sam Basch** said on Friday.

Basch said, however, that it was too early to determine what percentage would be allocated to black economic empowerment (BEE) firms and small, medium

# Denel offers an Impressive Product and Service Portfolio. . .



# Overview of Aviation Businesses



## DEVELOPMENT AND LOW VOLUME PRODUCTION



Unmanned Aerial Vehicles



Missiles



Optical and laser technologies

## AIRCRAFT COMPONENT DESIGN, MANUFACTURE AND ASSEMBLY



Gripen fighter



Agusta A109



A400M

## AIRCRAFT MAINTENANCE AND UPGRADES



Helicopters



Fixed-wing transport



Fighters

# DLS Lyttelton has Several World Class Products in Its Portfolio



## DEVELOPMENT AND PRODUCTION OF LARGE CALIBRE ARTILLERY



## DEVELOPMENT AND PRODUCTION OF MEDIUM AND SMALL CALIBRE WEAPONS



## MAINTENANCE AND UPGRADES



# Fixed Cost Problem



- Insufficient local sales
- Export business takes place to fragmented export markets, mostly developing countries
- This export business is start-stop type business
- Generally less politically stable markets
- High sales costs
- These markets buy mainly on price and no long term repeat order business is achieved.



# A Process of Discovery



- Legal agreements
- Legacy contracts
- Poor delivery culture
- Poor management skills
- Governance issues
- Labour issues.



# A Process of Discovery



- Discussions with stakeholders to improve order cover
- Discussions with industry to improve synergies
- Legal agreements and Legacy contracts – renegotiate or terminate
- Sell off non-core assets R1bn
- New and/or improved management skills
- Improved governance issues and controls
- Labour issues resolved.



# Financial Indicators





- **Background**
- **Strategy Update**
- **Business Unit Status**
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# Our Challenge



## 'Fixing' Denel means . . .

- Becoming a profitable, commercially viable and dynamic entity
- Delivering consistent, real growth
- Attracting, developing, retaining and appropriately rewarding world-class skills
- Achieving world class productivity
- Focusing on the areas where we can compete credibly
- Partnering with state agencies to meet the defence needs of the country
- Developing partnerships/alliance ventures with true value add.

# Key Messages



1. Much of the global defence spend is inaccessible to independent contractors, making players highly reliant on their domestic markets. Furthermore, changes in the industry are forcing players to consolidate, build alliances and carefully focus their businesses
2. Denel no longer has a large domestic market to provide the scale to succeed as an independent global systems integrator and exporter of a broad range of products on the international markets
3. To succeed, Denel is pursuing a strategy based on prime contracting in the domestic market and the export of systems and components through selective equity partnerships and alliances with global prime contractors.



# The Global Defence Industry Has Undergone Significant Change Over the Past Decade, and the Pace of Change Will Increase



## FORCES FOR CHANGE

Declining defence spend

Changing nature of conflicts and shifting customer needs

## IMPLICATIONS

- Lengthening product life cycles and reducing demand for new platforms
- Shift to smaller, more mobile weapons and increasing use of electronics
- Increasing consolidation to achieve minimum scale
- Smaller players forming global alliances and focusing on:
  - Supply of systems, sub-systems and components to alliance partners
  - Fulfilling maintenance and upgrade role for domestic customer

# Declining Defence Spend and Increasing R&D Costs Have Driven Consolidation of Prime Contractors Across All Sectors



## US AEROSPACE EXAMPLE

In 1992, the US Defence Department encouraged manufacturers to merge in order to cope with drastic budget cuts:

*“By 1996, American defence budget expenditure on equipment procurement and R&D will fall by over 40%, from \$117b to \$68b”*

## 1992: Over 30 companies

- Lockheed Martin
- General Dynamics A/C
- Martin Marietta GE Aerospace
- Loral
- Computer Affiliated Svc. Inc.
- Rockwell Aerospace
- McDonnell Douglas
- Hughes Space
- Continental Graphics
- Jeppesen
- Flight Safety Training
- Raytheon
- BAE Corp Jets
- E-Systems
- Texas Instruments (Def.)
- Hughes Defense
- General Dynamics
- Bath Iron Works
- NASSCO Holds.
- Gulfstream
- Galaxy Aerosp.
- Motorola IISG
- GM Defense
- Veridian
- Northrop Grumman
- Grumman
- Westinghouse ESD
- Logicon
- Aerojet EIS
- Newport News Ships
- TRW
- XonTech

## 2005: Five consolidated groups

**Raytheon**



**GENERAL DYNAMICS**



# Looking Ahead, Successful Players Will Require Both Privileged Access and a Commercial Orientation



## PRIVILEGED ACCESS

Captive Market

Political Support

- Large domestic demand and guaranteed access to domestic programmes
- Reliable multi-year R&D funding to retain a technological edge in an increasingly globalised market
- Consistent, active support from government for export sales

## COMMERCIAL ORIENTATION

Focus

Alliances

Excellent Execution

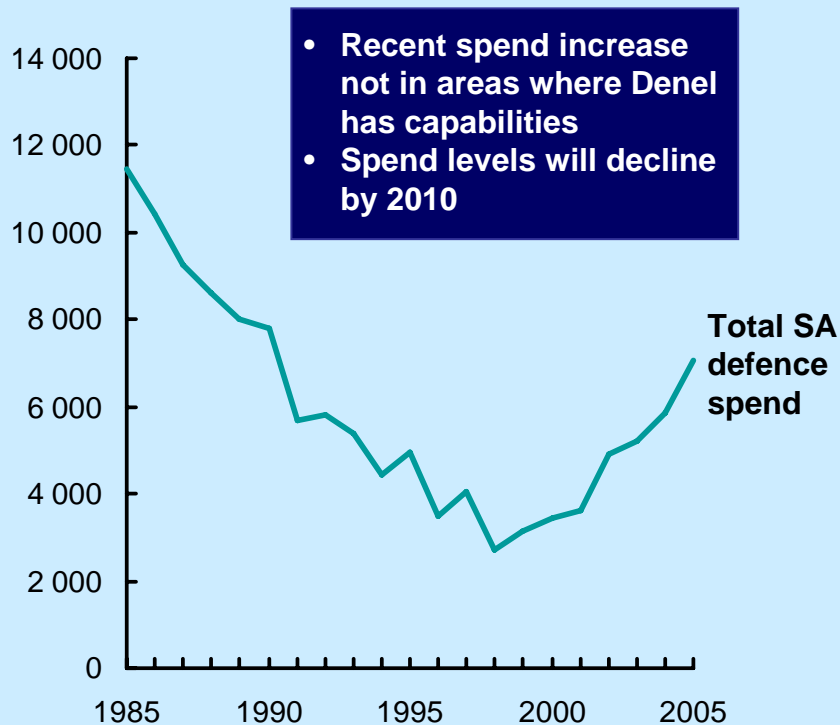
- Specific products or roles in the value chain with defensible positions
- Integration into a network of OEMs and sub-suppliers to gain market access, skills and minimum scale
- World class capabilities and productivity

# Denel has Largely Lost its Captive Domestic Funding Base . . .

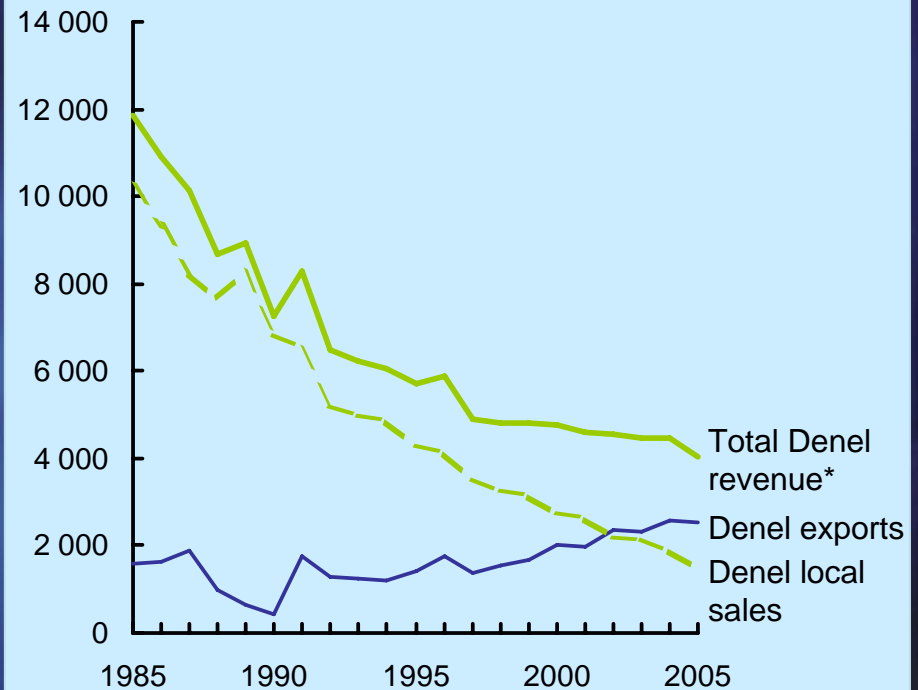


Rm, Real 2005

## RSA Defence Spend Recovered Since 2000 . .



## . . . But Denel did not participate in this recovery



\*Pre-1992 figures estimated from Armscor and defence industry data

ESTIMATES



# ... The Five Industry Success Factors Should Form the Founding Principles of the Future Denel



## PRIVILEGED ACCESS

Captive Market

Political Support

## COMMERCIAL ORIENTATION

Focus

Alliances

Excellent Execution

## WHAT THIS MEANS

1. Secure **privileged access** to a guaranteed minimum proportion of RSA defence development and procurement spend
2. **Partner with the state agencies** – joint business planning and export marketing responsibilities
3. **Focus** on growing the **commercially viable** businesses where Denel has real technological leadership; other businesses ring-fenced or operated under management contracts
4. Secure scale through **equity business partnerships** with major global players
5. Raise **capabilities and productivity** to world class levels; exit businesses where this cannot be achieved



# Strategy Imperatives

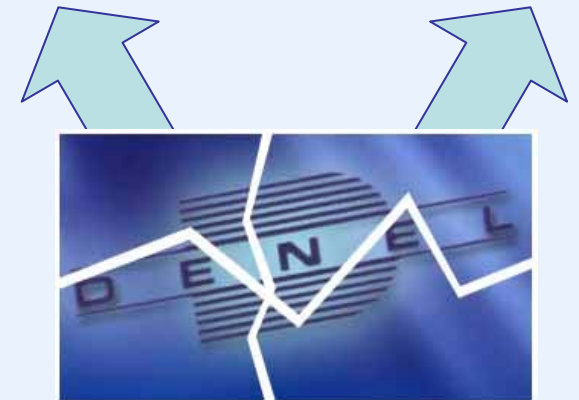
## Single Vision Anything Else Will Not Help



From: Misalignment Amongst Stakeholders

President  
and  
Cabinet

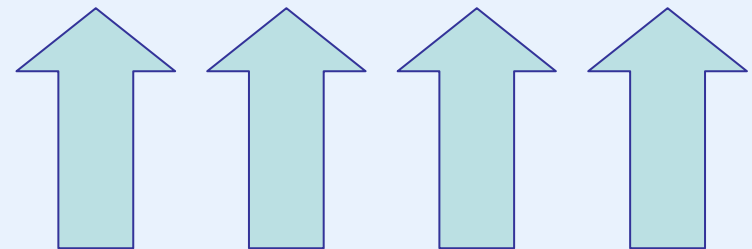
Portfolio Ministers –  
DPE, DoD, Foreign  
Affairs, Finance



Denel  
Board

Denel  
Executive  
Team

To: Single Vision and Purpose



**One Team**

President and Cabinet  
Portfolio Ministers / DOD  
Denel Board  
Denel Executive Team

# The Five Pillars of the Macro Strategy



1. Secure **privileged access** to a guaranteed minimum portion of South Africa's defence development and procurement spend.

2. **Partner with state agencies** to do joint business planning and to establish export marketing responsibilities. These two factors translate into the 'captive market' and 'political support' that make international major defence prime contractors successful.

3. Focus on growing the **commercially viable** businesses where Denel has real technological leadership. Denel's other businesses will be ring-fenced, operated under management contracts or exited.

4. Secure **equity business partnerships** with major global players.

5. Raise **capabilities and productivity** to world-class levels.

1

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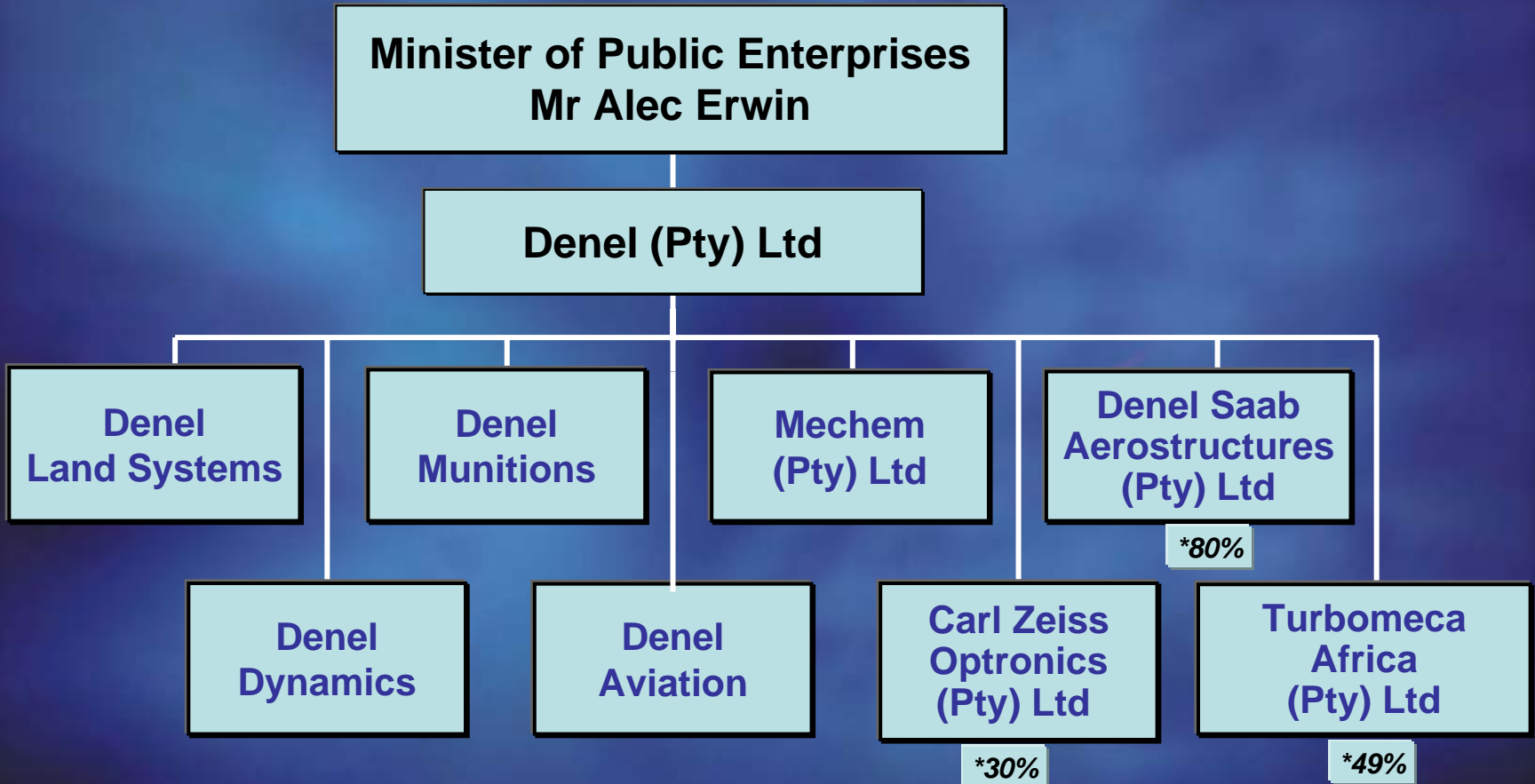
Implement effective **transformation and people management** throughout the organisation.

**FOUNDATION STONE**

- **Background**
- **Strategy Update**
- **Business Unit Status**
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# Denel Structure



\* Denel Shareholding

# Structured Approach

## Structured Denel NewCo Approach



### PHASE 1 (Explore)

- Identify Potential Partners
- Develop Business Plan
- Ring Fence Business

### PHASE 2 (Uncover)

- Full Risk Assessment
- Data Room - Full Disclosure
- Due Diligence with Partner

### PHASE 3 (Define)

- Recap/Guarantees
- Business Arrangements
- Equity Partner & SANDF

### Structured Risk Management in Place

#### NewCo Approach Outcomes:

- Restructured Businesses:
  - Exit “bad” Business
  - Access Markets - Stable Turnover/Order Books
  - Rightsized
  - Inject Management Skills - Improve Operations
  - Apply Recap/Guarantees
  - More Defence Spend Access
- Performance Based Contracts
- NewCo Board - Strengthen Governance
- Ring Fenced PTY (Ltd) Risk Containment

# Equity Partner Process



- SAAB / Denel Aerostructures – completed 2007
- Zeiss / Optronics – completed 2007
- Turbomeca Africa – completed 2002
- Denel Munitions – Equity Transaction proposal submitted and approved by Denel Board (PFMA application submitted)
- Denel UAVs – Equity Transaction proposal submitted and approved by Denel Board (PFMA application submitted).



# Denel Munitions



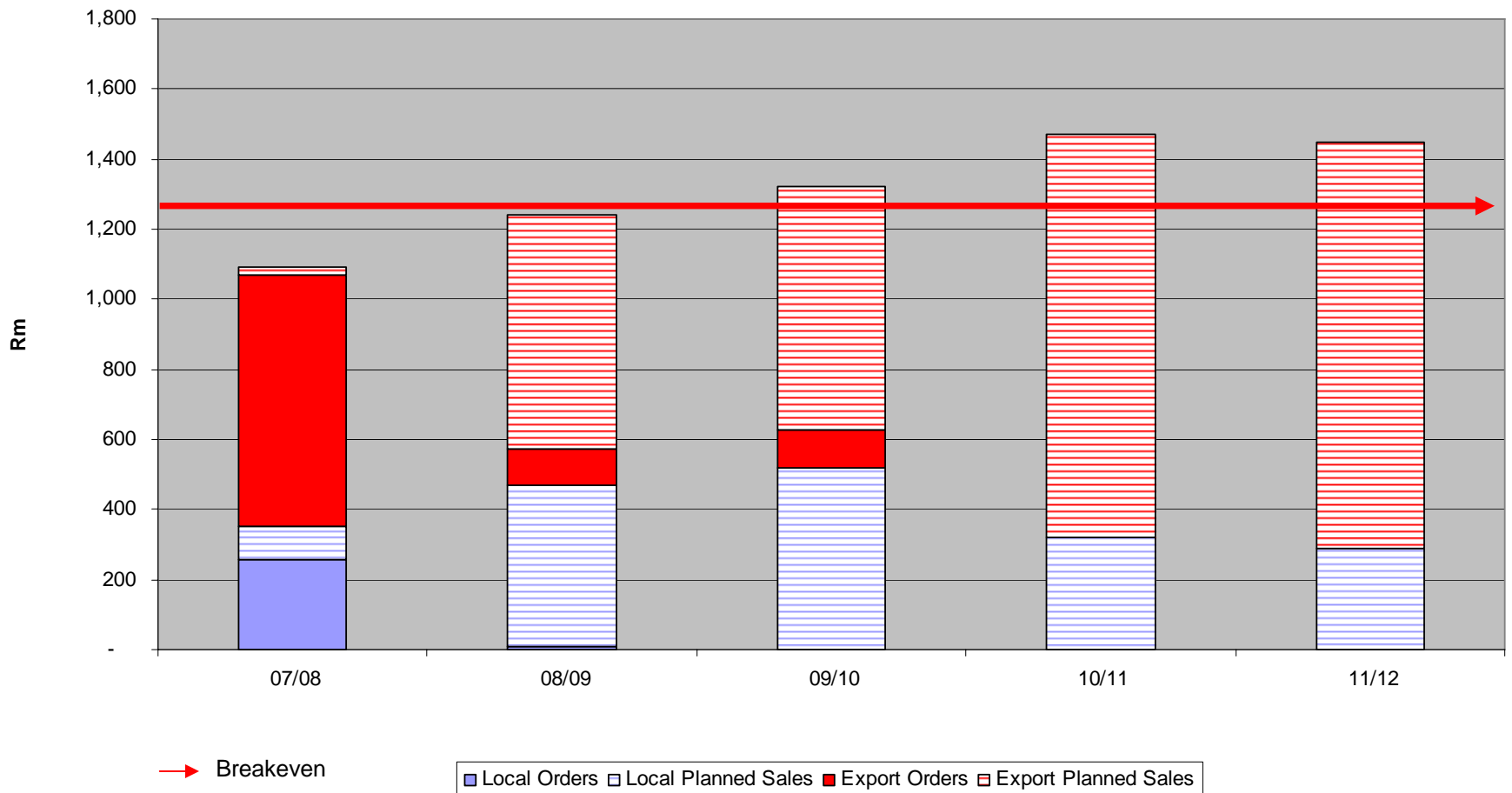
- Core Competencies – Current
  - Design and manufacture of small, medium and large calibre ammunition and ammunition manufacturing facilities
- Future Focus
  - International niche markets for innovative products
  - Insensitive munitions (IM)
  - Equity partner shareholding, on-going discussions with a major European company
  - Potential split of small and medium calibre from other Munitions business
- Turnover/Staff
  - R1,100m/3100.



# Denel Munitions



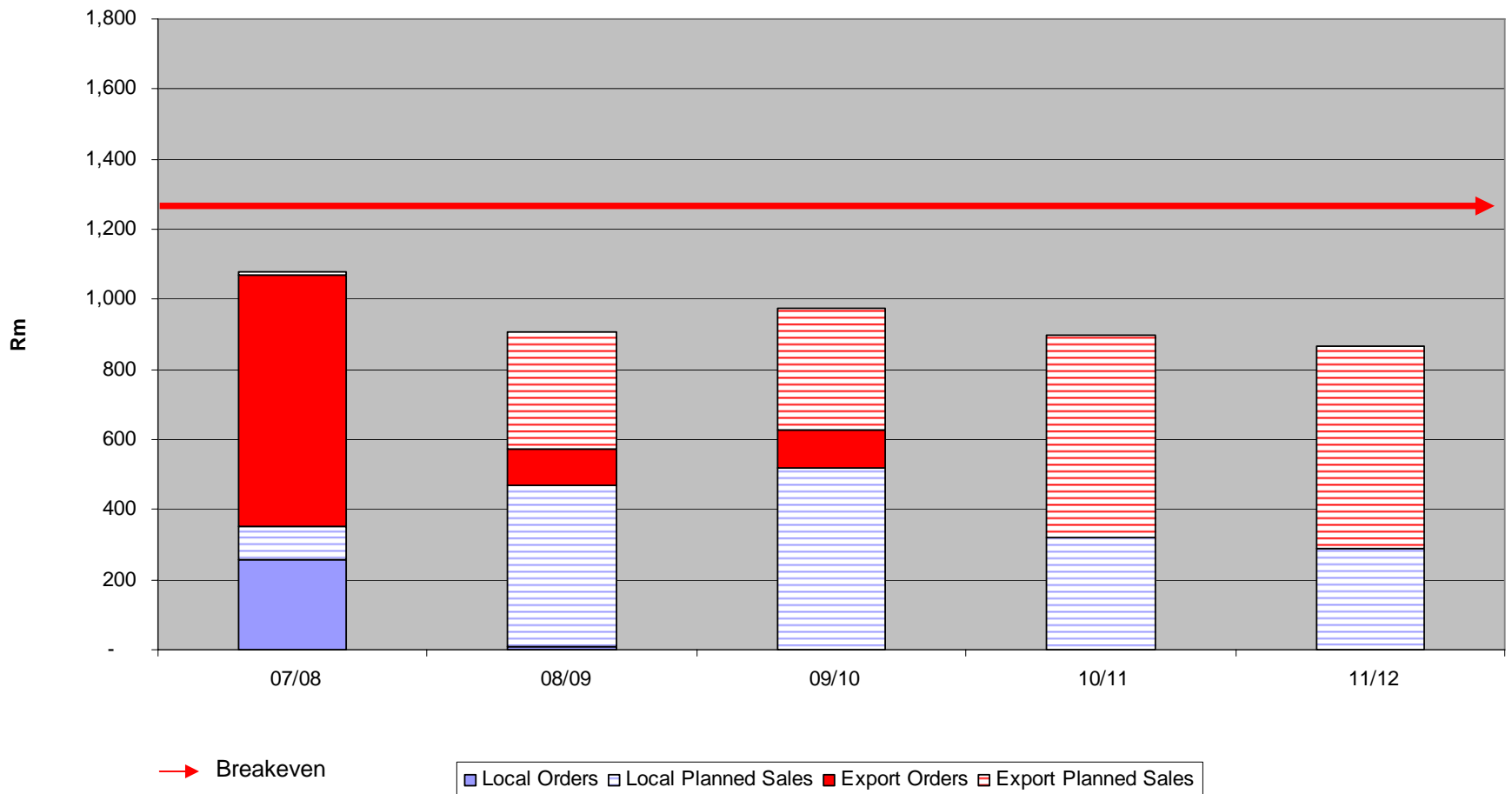
DENEL MUNITIONS  
Sales Risk Analysis



# Denel Munitions



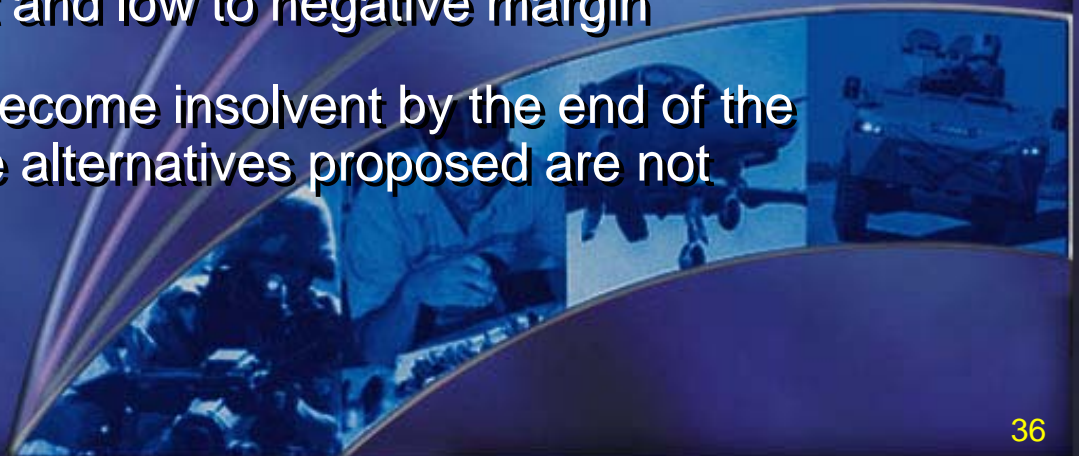
**DENEL MUNITIONS**  
(Exports at a 50% success)



# Areas of Concern - Munitions



- Far short of orders for current year or future years – breakeven R 1.2 billion
- Current local orders from SANDF circa R 120 million
- Uncertainty with regard to further orders to be placed for current year by SANDF
- No visibility on future requirements for SANDF
- Export orders inconsistent and low to negative margin
- This business is likely to become insolvent by the end of the current financial year if the alternatives proposed are not implemented



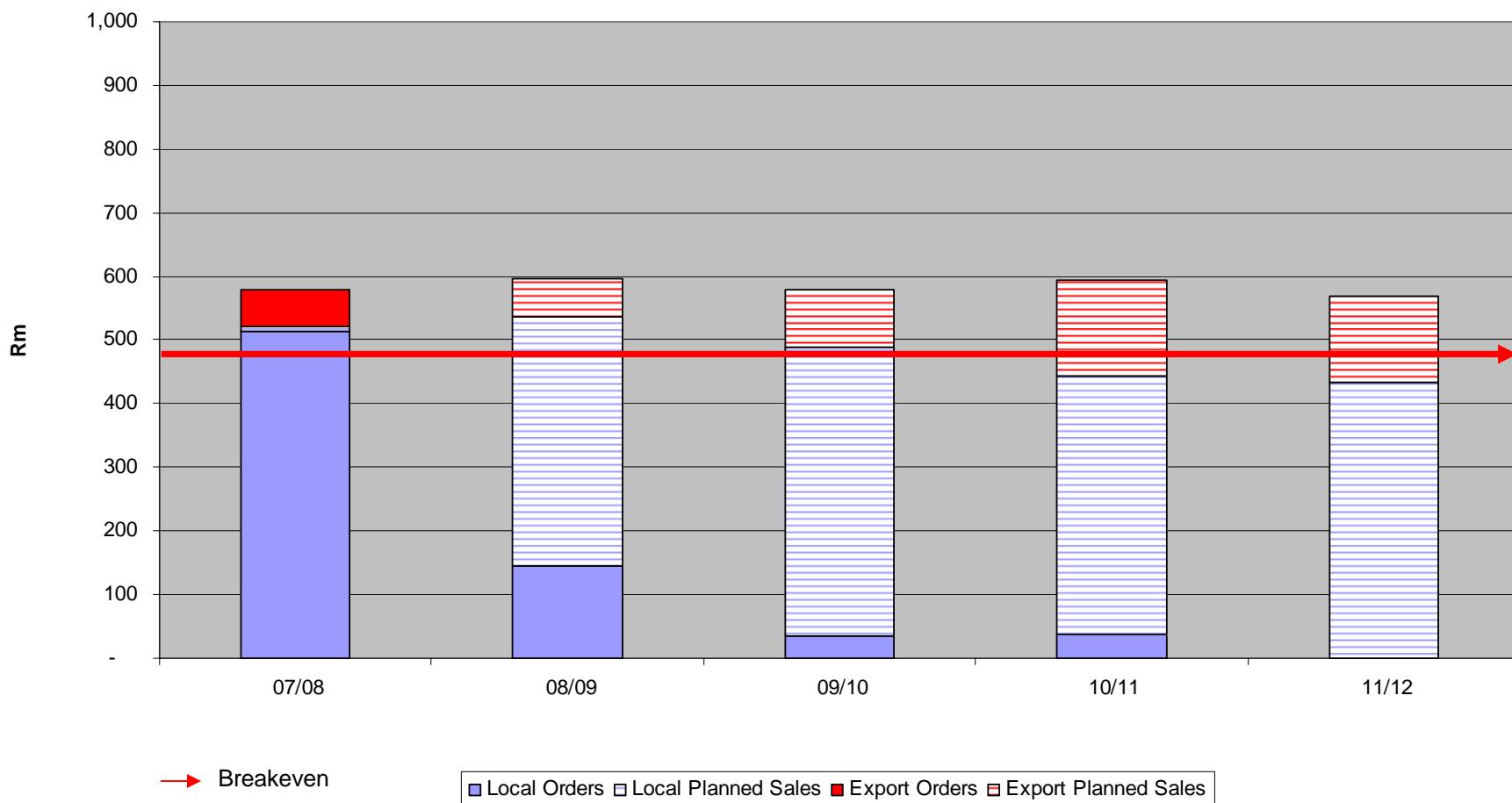
# Denel Aviation



- Core competencies - Current
  - Accredited maintenance and repair organisation (MRO) for military and civilian fixed-wing and rotary-wing aircraft
  - Rooivalk now reporting through to Aviation
- Focus
  - Further international accreditation and PSS
  - Worldwide trend to outsourcing maintenance
  - An annual growth of 10% is projected in this market for the next 10 years
- Turnover/Staff
  - R550m/1300.



**DENEL AVIATION**  
Sales Risk Analysis (Excl AMG Order)



# Areas of Concern - Aviation



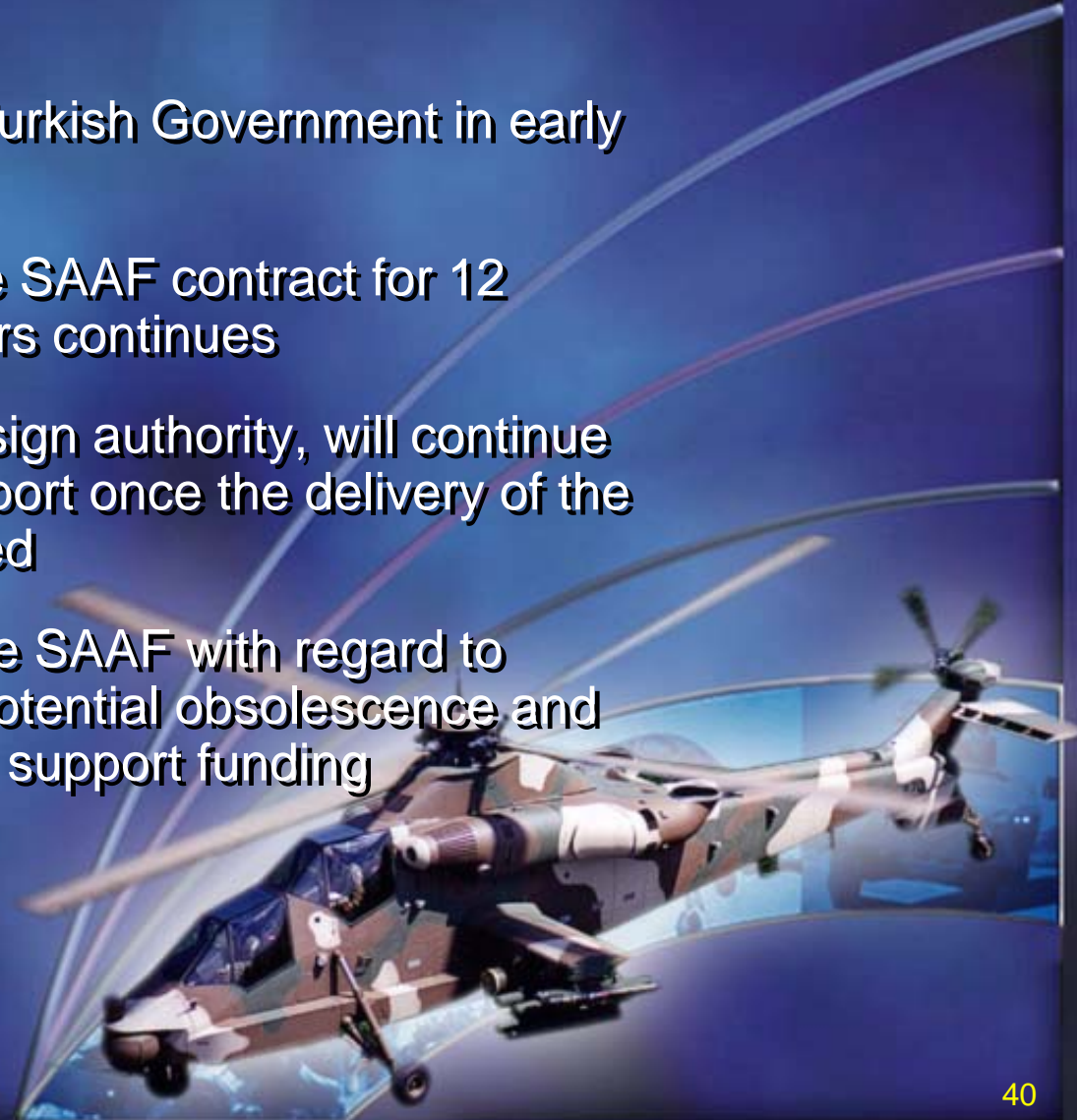
- Duplication between SAAF and Denel Aviation in areas of manpower, equipment, facilities
- Opportunity exists to create a model of co-sharing of all resources
- Benefit will lead to overall efficiency in Maintenance and Repair activities in line with international best practice
- This will lead to cost optimisation
- Due to relatively high number of platforms, each with low volumes, critical mass becomes difficult
- As such, a model of “single source” supply will be required for new generation platforms.



# Denel Aviation - Rooivalk



- Denel lost the bid to the Turkish Government in early 2007
- The implementation of the SAAF contract for 12 Rooivalk Attack Helicopters continues
- Denel Aviation, as the design authority, will continue to provide after sales support once the delivery of the 12 helicopters is completed
- Strategic decision from the SAAF with regard to Rooivalk required given potential obsolescence and redundancy and longterm support funding requirements





# Denel Dynamics



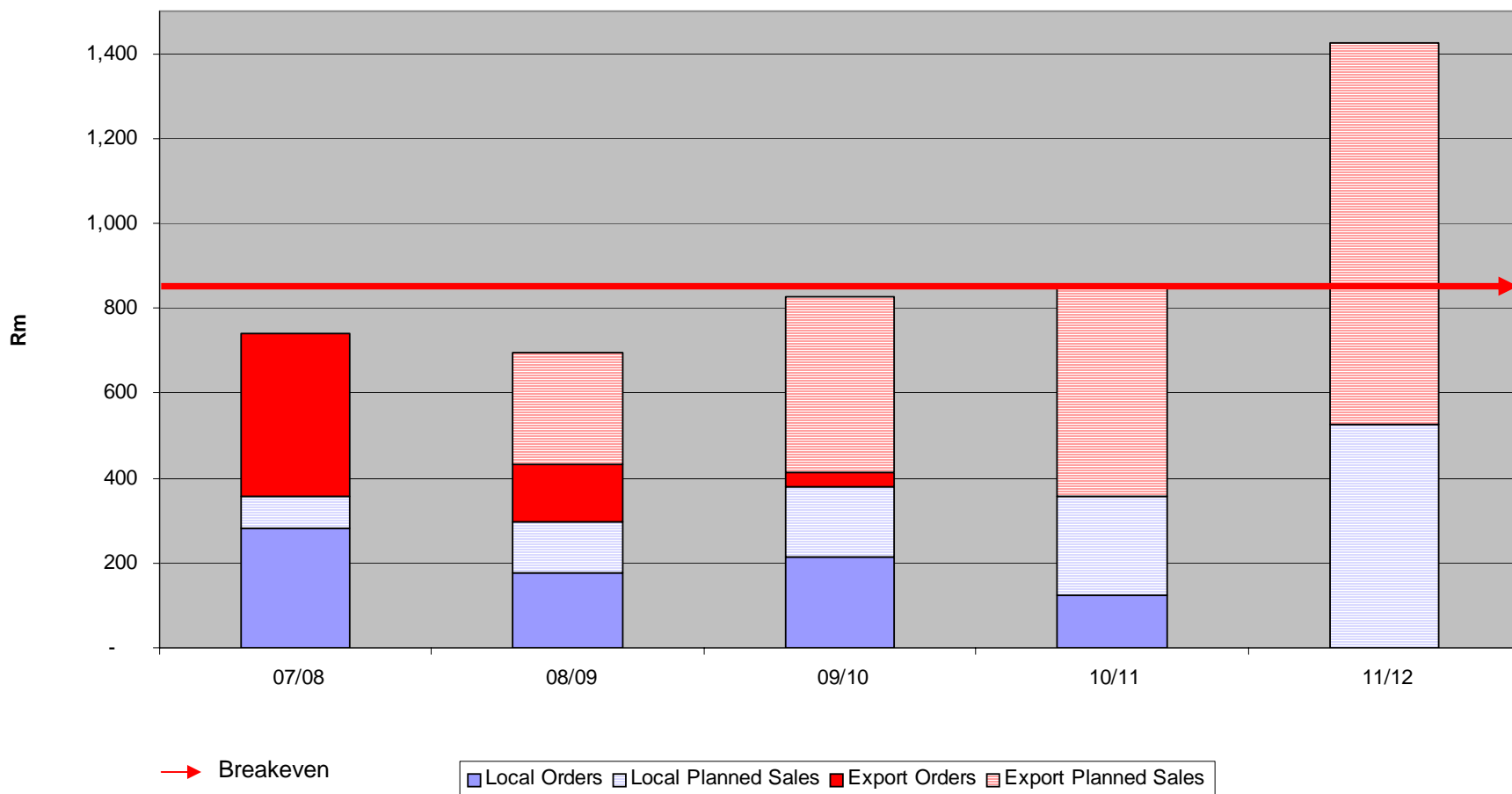
- Core competencies - current
  - Missiles, DISS and UAVs
- Products
  - Ingwe, Mokopa, Umkhonto, A-Darter, R-Darter, Seeker 2, Skua, Umbane and Arachnida (WMS), Raptor, GBADS.
- Future
  - Unbundle Missiles, UAVs and DISS
  - Implement strong outsource model
  - Investigate “home” for R&D
- Turnover/Staff
  - R750m/800.



# Denel Dynamics



## DENEL DYNAMICS Sales risk analysis



# Areas of Concern - Missiles



- The business cannot achieve sufficient sales to cover overheads in the short to medium term
- A-Darter has no production orders as yet
- Business has a number of legacy contracts that must be addressed
- The business will become insolvent by the end of the current financial year unless all stakeholders find a solution
- Various strategies are being investigated to retain capability and to look at optimising the capability



# Denel Land Systems



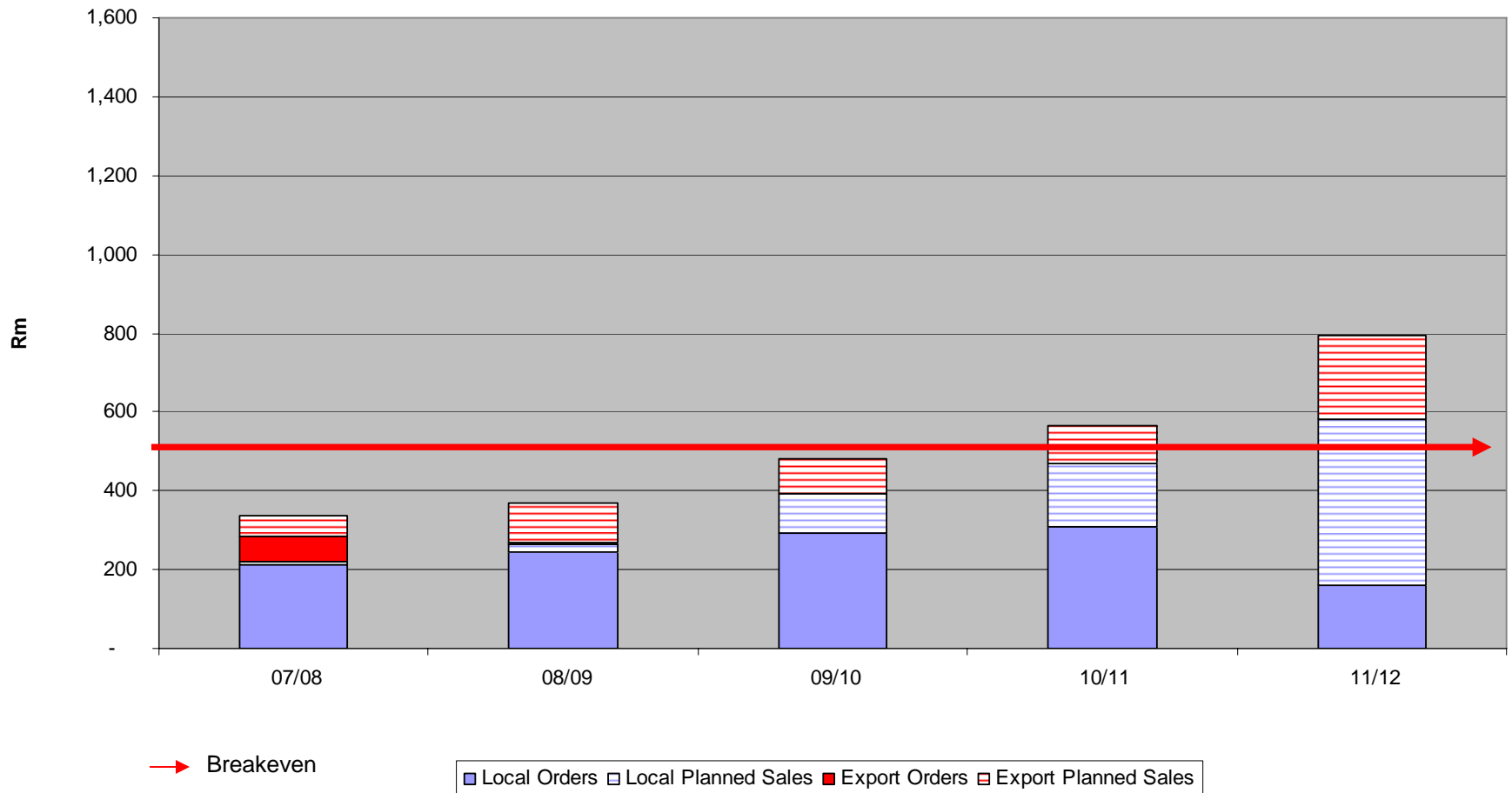
- Hoefyster will create future base load/ Company remains effectively a single project company
- Very dependent on Hoefyster production orders - Needs alternative revenue from international markets
- Future Focus
  - Focused provider of landward Defence systems solutions
  - Equity partner/s with consolidated local and international industry
  - Prime contractor, system integrator and supplier of subsystems in infantry weapons, artillery gun systems, combat turrets (small arms?)
- Turnover /Staff
  - R430m/440.



# Denel Land Systems



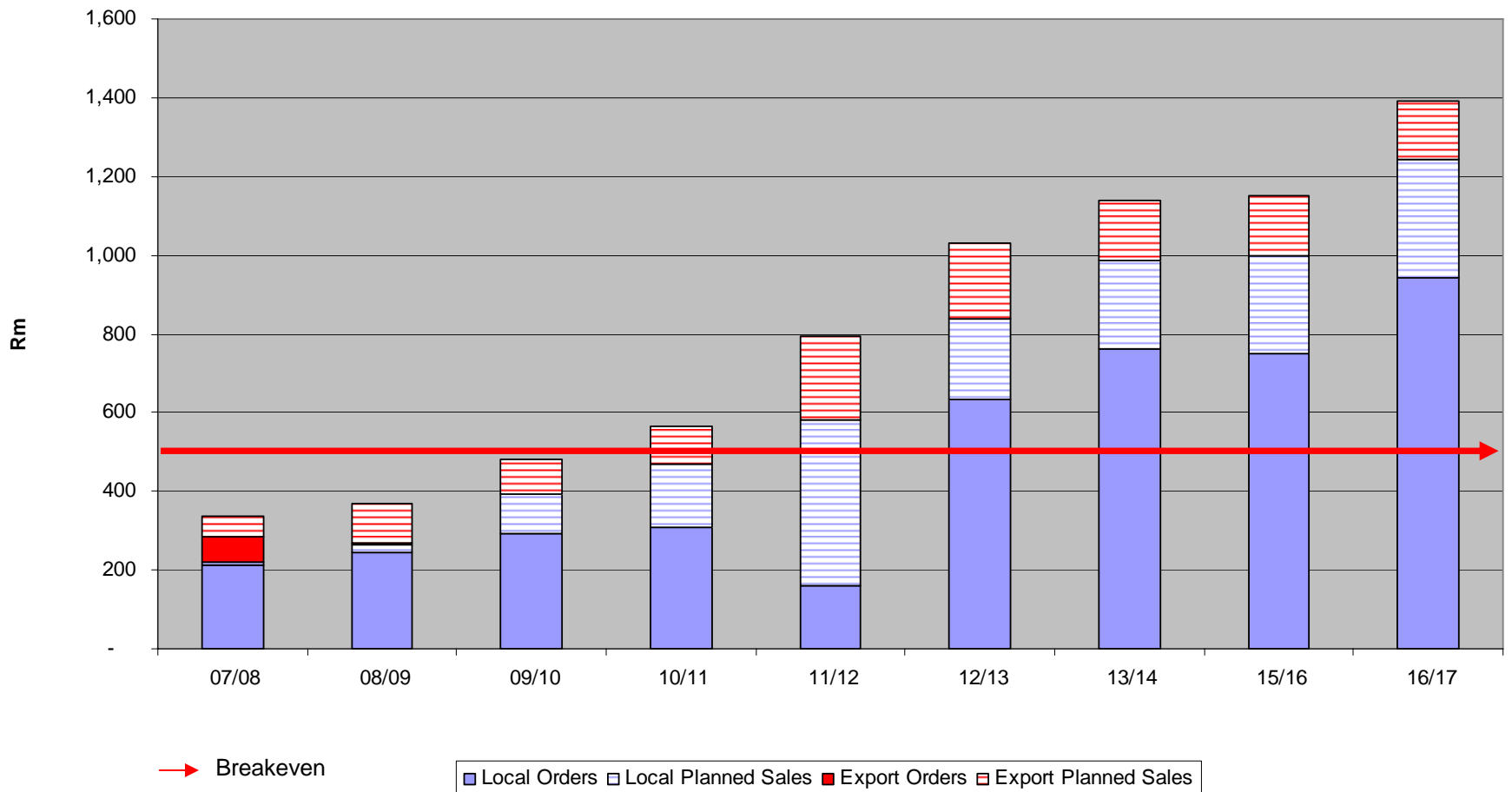
**DLSL**  
**(Exports at 50% success)**



# Denel Land Systems



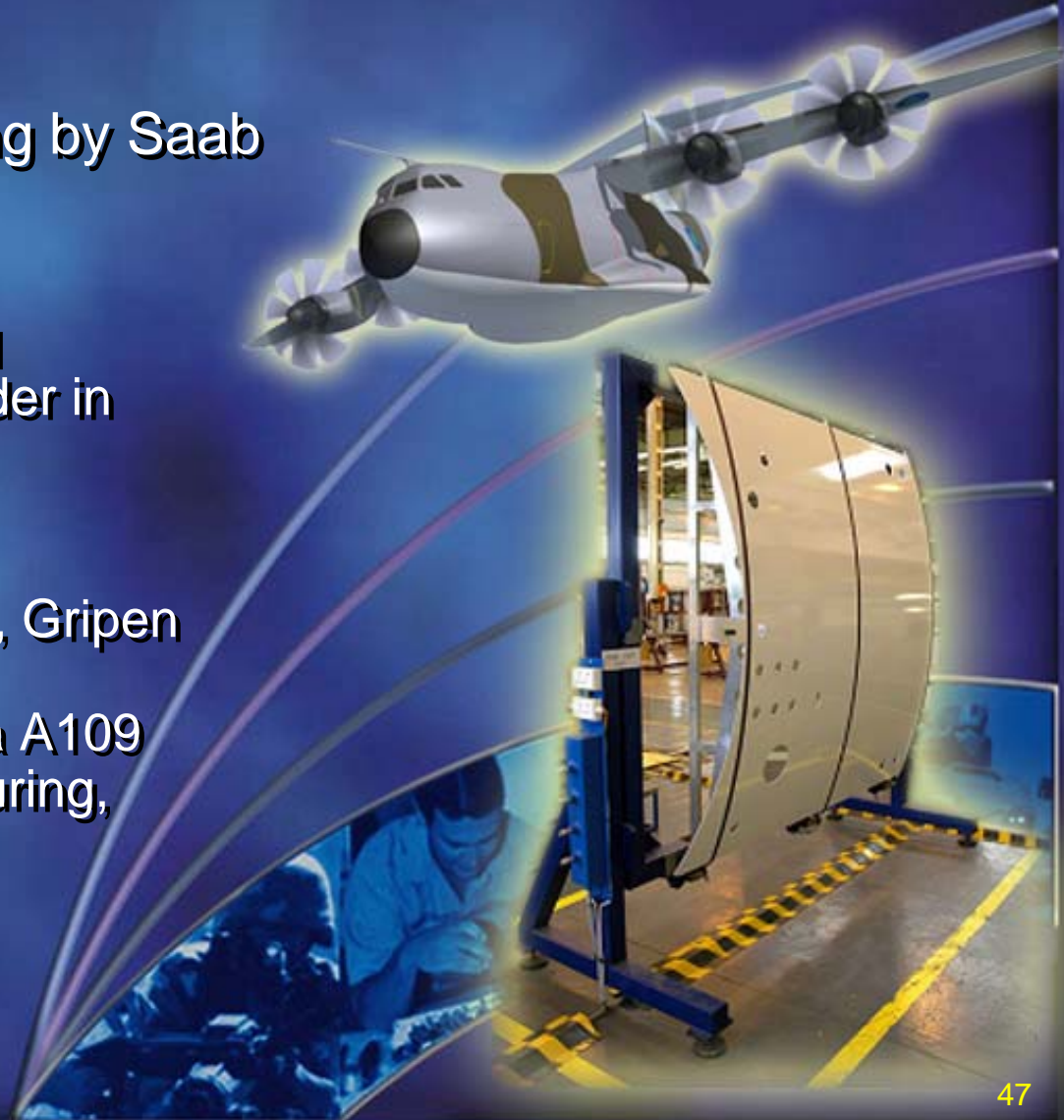
DLSL  
(Exports at 50% success)



# Denel Saab Aerostructures (Pty) Ltd



- 20% Equity shareholding by Saab AB
- Focus on composites, aerostructures design and manufacturing, global leader in aerostructures for Africa
- Current Products
  - A400M aerostructures, Gripen aerostructures, Hawk aerostructures, Agusta A109 assembly & manufacturing, Boeing components
- Turnover/Staff
  - R220m/780.



# Carl Zeiss Optronics (Pty) Ltd



- Equity Partnership
  - Denel shareholding 30%
- Core competencies
  - Design, development, manufacture and support of military and civilian electro-optical products.
- Products
  - Range of image-stabilized optical surveillance systems, laser range-finders and helmet-mounted sighting and tracking systems.
- Turnover/Staff
  - R330m/370.





# Mechem (Pty) Ltd



- Future Focus
  - Local and international markets for landmine clearance and contraband detection.
- Prospects
  - UN estimates there are 110 million landmines across 15 countries
  - Strategic decision made to diversify into contraband detection.
- Turnover/Staff
  - R110m/50.



- **Background**
- **Strategy Update**
- **Business Unit Status**
- **Year-End Results**
- **Order Pipeline and General Progress**
- **Annual Report**
- **Conclusion**



# Financial Highlights – 06/07



Item	2007 R millions	2006 R millions
Turnover	3,268.1	2,773.2
Gross profit	754.0	(131.1)
Loss before taxation	(500.9)	(1,291.4)
Net Loss	(549.1)	(1,363.4)



# Group Income Statement for the Year Ended 31 March 2007



Description	Year-end		
	31-Mar-07	31-Mar-07	31-Mar-06
	Actual <i>Rm</i>	Budget <i>Rm</i>	Actual <i>Rm</i>
Turnover	3,268.1	3,598.2	2,773.2
Gross profit/(loss)	754.0	553.5	(131.1)
<i>GP as % of revenue</i>	23%	15%	-5%
Other income	116.6	6.5	209.9
Operating costs	(1,257.4)	(1,109.2)	(1,155.1)
<b>Operating profit (loss)</b>	<b>(386.8)</b>	<b>(549.2)</b>	<b>(1,076.3)</b>
Interest paid	(143.0)	(96.1)	(187.8)
<b>Profit (loss) on ordinary activities before tax</b>	<b>(500.9)</b>	<b>(677.3)</b>	<b>(1,291.4)</b>
Tax	(6.4)	(6.9)	(19.3)
Income from associates and minority interest	28.9		3.6
<b>Profit (loss) on ordinary activities after tax</b>	<b>(549.1)</b>	<b>(684.2)</b>	<b>(1,363.4)</b>

# Balance Sheet

## – 31<sup>st</sup> March 2007



Description	31 March 2007	31 March 2006
	Actual Rm	Actual Rm
Non-current assets	1,348	1,601
Current assets	2,615	2,724
• <i>Trade and other receivables</i>	1,147	883
• <i>Inventories</i>	1,067	984
<i>Non-current assets held for sale</i>	540	352
<b>Total assets</b>	<b>4,504</b>	<b>4,677</b>
Total equity	633	614
Non-current liabilities	856	2,096
Current liabilities	2,999	1,938
• <i>Trade and other payables</i>	627	561
• <i>Provisions</i>	801	546
<b>Total equity and liabilities</b>	<b>4,504</b>	<b>4,677</b>

# Cash Flow Before Financing Activities

– 31<sup>st</sup> March 2007



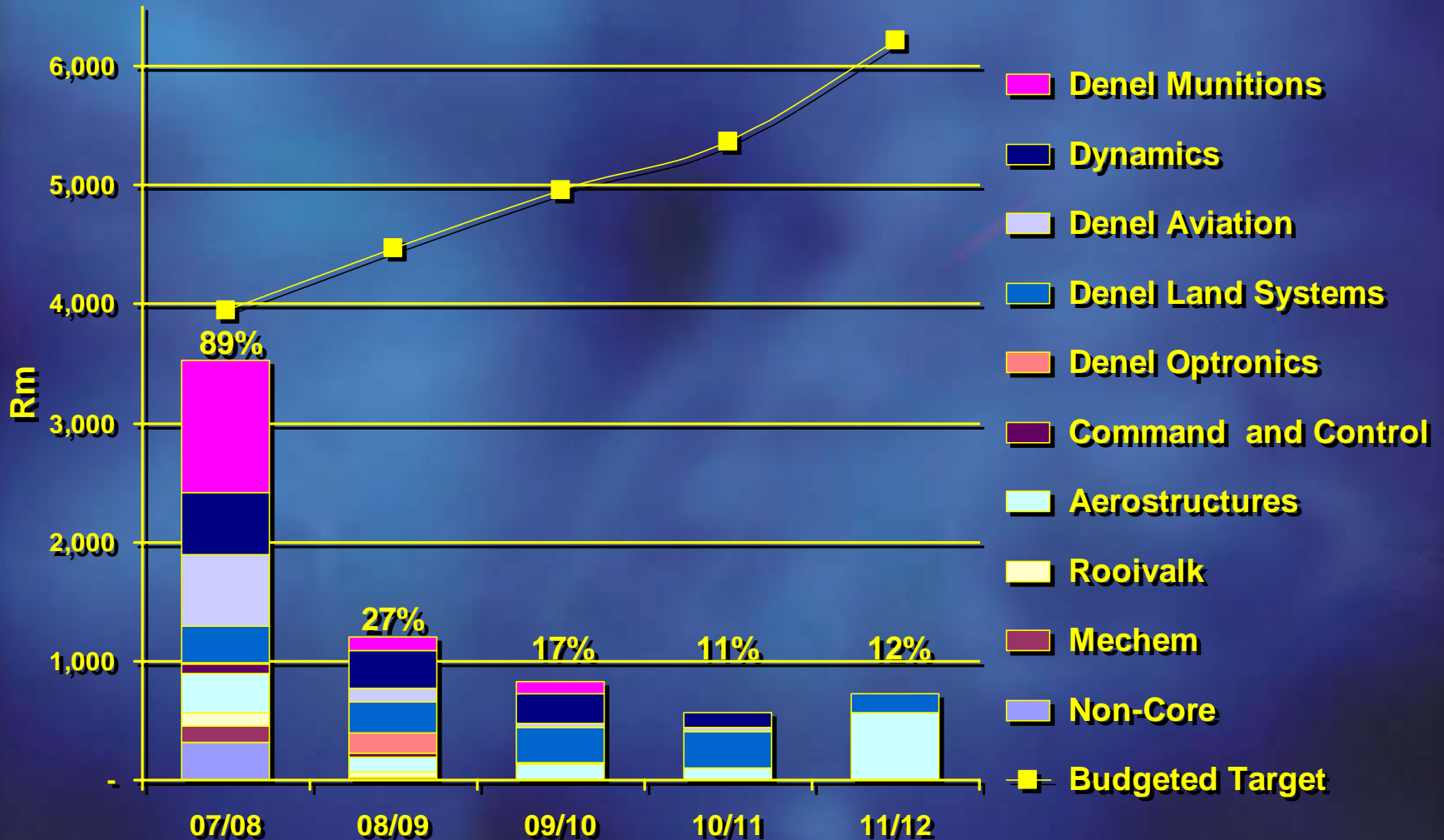
Description	31 March 2007	31 March 2006
	Actual Rm	Actual Rm (restated)
Cash utilized in operating activities	(1,015.0)	(1,146.6)
Cash flow from / (utilized in) investing activities	69.5	85.7
Cash flow before financing activities	(945.5)	(1,060.9)
Cash flow from financing activities	555.0	1,482.7
Net (decrease) / increase in cash and cash equivalents	(390.5)	421.8
Cash and cash equivalents at the beginning of the year	730.2	305.5
Cash movement of entities held for sale	(1.3)	2.9
<b>At the end of the year</b>	<b>338.4</b>	<b>730.2</b>

- **Background**
- **Strategy Update**
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# Consolidated Order Pipeline

as at 12 September 2007





# Positive Progress - Stakeholders



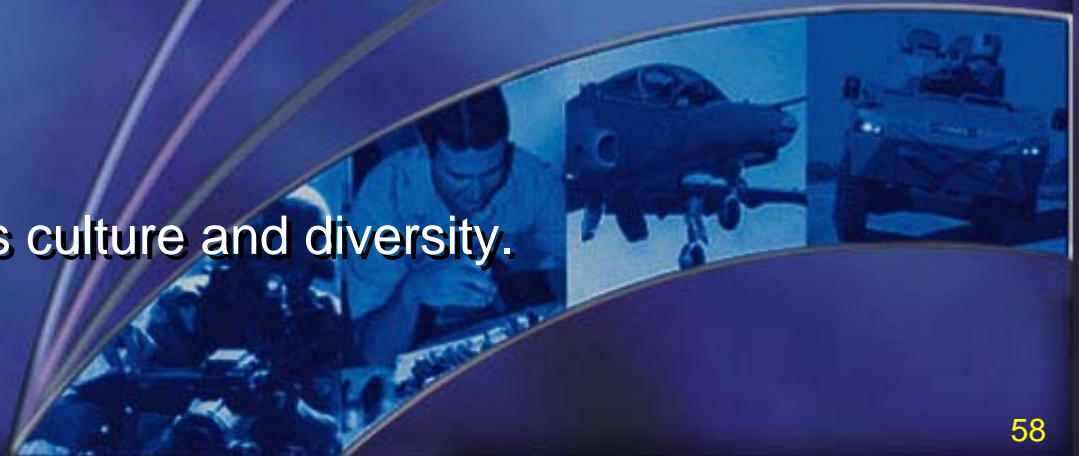
- SANDF / DoD / Armscor seem to understand the issues at Denel and SADRI, and are more willing to find solutions although long term orders are still an issue
- Far more interaction taking place at all levels, including progressive interactions with SADRI role-players
- DoD community interacting well across Denel and Denel Divisions
- Hoefyster great contributor to overall industry motivation, a result of collective drive from all stakeholders.



# Positive Progress – Internal to Denel



- Unbundling into separate entities progressing
- Focus on project delivery, on schedule and at specified quality
- Processes and systems improvement
- Cost controls, productivity and efficiency
- Contracting capability
- Customer focus
- Sales pipeline
- Transformation, business culture and diversity.



# Positive Progress - GBADS



- GBADS has come through the worst and is well on its way to recovery
- Latest PMR review satisfactory
- Closer project collaboration with Arm Scor and SANDF bearing fruit to ensure timelines are met
- First missile firing in October in line with new schedule with Chief of Army
- Software acceptance has been completed
- Moving into integration phase



# Denel 2007 and Beyond



- Denel (Pty) Ltd
  - 100% State-owned holding company
- Eight to ten focused (Pty) Ltd companies
  - Responsible for their own profit/losses
  - Independent Balance-sheet
  - Ring-fenced
- Equity partners bring global expertise, market access and R&D
- Denel shareholdings range between 26% and 100%
- Various Government and Shareholder agreements protect IP, security of supply and include relative pre-emptive rights
- Further consolidation of industry in RSA now possible and feasible
- Within 24 to 36 months Denel will be financially viable on a sustainable basis if all plans, some of which are outside Denel's control, are implemented.

- **Background**
- **Strategy Update**
- **Business Unit Status**
- **Year-End Results**
- **Order Pipeline and General Progress**
- **Annual Report**
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# Chairman's Report



- Denel is a strategic asset
  - SA needs a competent defence industry to support the SANDF
  - A competent local industry provides a large measure of strategic independence
  - This facilitates product development for local conditions
- Cutting-edge technology
  - Need for highly-skilled personnel and training
  - Denel offers an opportunity to develop these skills
  - These occur through the Denel Centre for Learning & Development (DCLD) and through partnerships with local and foreign companies
- The Government has funded much of Denel's technology capability for many years
  - This investment needs to be protected and nurtured
  - Export opportunities are available in the areas of missiles, unmanned aerial vehicles, artillery and munitions.

# Group CEO's Report



- Significant progress made in the past year:
  - Reduced loss from the previous year
  - Unbundling of the organisation into independent businesses
  - Focus on revenue generation by the businesses
  - Commercial viability study completed on all businesses and the implementation of individual strategies
- Awarded the largest contract in the company's history:
  - Project Hoefyster – Badger Infantry Fighting Vehicle
  - R8-billion contract for 264 vehicles
- Total re-engineering of Denel:
  - Climate survey implemented to improve staff perceptions
  - New performance management system implemented
  - Appointment of a group executive to specifically handle transformation
  - Reporting structures improved across the entire group.

# Directors' Report



- Directors responsible for preparation, integrity and fair presentation of Group Annual Financial Statements of Denel (Pty) Ltd and its subsidiaries.
  - Statements presented in accordance with International Financial Reporting Standards, SA Companies Act and Public Finance Management Act
  - Appropriate to use going concern basis for financial statements
  - External auditors responsible for independent auditing and reporting.





# Directors' Report (contd.)



- The Group:
  - Established 1 April 1992 as private company
  - Incorporated in terms of SA Companies Act No. 61 of 1973
  - SA Government sole shareholder
  - Listed Schedule 2 Public Entity in terms of the PFMA
  - Headquartered in Irene, Centurion
  - The Group's business entities operate in SA and abroad
- Description of Business:
  - Technology-based company
  - Core: aerospace, land systems and defence/security related industries
  - Key capabilities: R&D, engineering and manufacturing of proprietary and other products throughout their lifecycles.

# Directors' Report (contd.)



- **Business Strategy:**
  - Five year corporate plan in place in terms of the PFMA
  - Currently in year two of the strategy to return the Group to profitability
  - Key performance indicators are contained in the Shareholders Compact
  - Progress is reported on a regular basis to the Directors, Executive, National Treasury and DPE
- **Good progress on the Macro Strategy:**
  - Secure “privileged access” (to South Africa’s defence spend)
  - Engage state agencies
  - Evaluate commercial viability (fix or exit) of business entities
  - Create equity based relationships / formal alliance partners
  - Raise productivity and capabilities to world-class standards.

# Directors' Report (contd.)



- Overview of Financial Performance:
  - Financial results:
    - Turnover increased by 17.8% to R3.3 billion
    - Net loss: R549 million, improvement on previous year R1,363 million
    - Net equity position improved to R633 million
    - Positive cash balance of R338 million
  - Financial Performance:
    - Turnover increased by R495 million from the previous year
    - Substantial progress on Umkhonto, Airbus, Agusta, GBADS and Aerostructures
    - Gross margin improved to 23% from a gross loss of –5% from last year
    - Operating costs as a percentage of sales reduced from 42% to 38%
    - Cost of Sales reduced from 105% to 77% as a % of sales.

# Directors' Report (contd.)



- Property, Plant and Equipment
  - Carrying value of assets decreased by R329 million being transferred to the “Held for Sale” category
- Share Capital and Share Premium
  - Only the shareholder is authorised to issue shares as above
  - No change in authorized share capital
  - During the year the company issued 126 836 290 Class A shares of R1.00 each, at a premium of R440 million to the Government as part of the recapitalisation of the company
- Dividends
  - No dividends were recommended for the 2006/07 year.

# Directors' Report (contd.)



- Non-core businesses:
  - Six businesses disposed of realising R413.3 million
    - Arivia.kom 2005/06
    - Irencoplastics 2005/06
    - Dendustri 2005/06
    - Voltco 2005/06
    - Irencoelectronics 2005/06
    - Bonaero Park 2006/07
  
  - SPP (Pty) Ltd in progress
  - Cosource (Pty) Ltd in progress
- Five more are at an advanced stage of disposal
- Sale of vacant and unutilised land carried out
- Borrowings:
  - A corporate Bond of R825 million matured on 16 August 2007 at 12.8% and was repaid
  - A Domestic Medium Term Note (DMTN) has been registered to fund future funding requirements.

# Directors' Report (contd.)



- **Going Concern:**
  - To date, the shareholder has provided recapitalisation of R3,500 million
  - The shareholder views Denel as a strategic asset and has agreed to support the Directors to maintain Denel as a going concern
  - Forecast negative cash position at 31 March 2007
  - Non-core asset sales resulted in proceeds of R606 million
  - The ability of the Group to continue as a going concern is dependent on the successful implementation of the business strategy
- **Human Resources:**
  - New performance management system implemented
  - Staff complement reduced from 8,120 to 7,634
  - 117 internal bursars, 101 external bursars
  - Denel Centre for Learning and Development has more than 200 students and the Apprentice School has 253 apprentices.

# Directors' Report (contd.)



- **Public Finance Management Act (PFMA):**
  - Group internal audit integrated in compliance with PFMA provisions
  - Findings are reported to the Audit and Risk Committee
  - PFMA contains certain onerous requirements
  - Despite progress, company not fully compliant in certain sections (e.g. Risk management, internal controls, irregular expenditure)
- **Companies Act:**
  - Directors confirm company lodged all returns as required.
  - Instances of non-compliance at subsidiary level:
    - Company registers not up to date
    - Annual returns not submitted
    - Year-ends not changed to that of Group
    - No Annual General Meetings held
    - No resolutions to approve financial statements
  - Most of the above have been rectified subsequent to the year-end.

# Risk Management



- The primary risk management objective is to protect the interests of the stakeholders and to ensure sustainability
  - On-going process to identify, manage, monitor risks
  - Management is responsible for:
    - Continuous identification, assessment and response to risk
  - The Board is ultimately responsible for:
    - Group risk management system
    - Review of effectiveness of system
  - Audit & Risk Committee tasked with:
    - Oversight and monitoring of risk management process
  - SHEQ policy and practices in place
  - Adopted OHSAS 18001 for occupational health and safety.



# Other Matters



- Corporate Governance
  - Denel is committed to the principles of good corporate governance as recommended by the King II Report and the Protocol on Corporate Governance in the Public Sector
  - Governance structures are in place to continuously improve accountability, integrity and the standard of reporting to facilitate informed decision-making
- Shareholder's Compact
  - The Shareholder's Compact for 2007 was signed on 1 December 2006
  - The Shareholder Compact:
    - Confirms Denel's mandate
    - Identifies the strategic objectives to be attained by Denel
    - Identifies the required key performance areas and indicators based on the 5-year Corporate Plan and reported in pages 50-51 of the Annual Report – most of which were achieved.

# Income Statement -

## - 31<sup>st</sup> March 2007

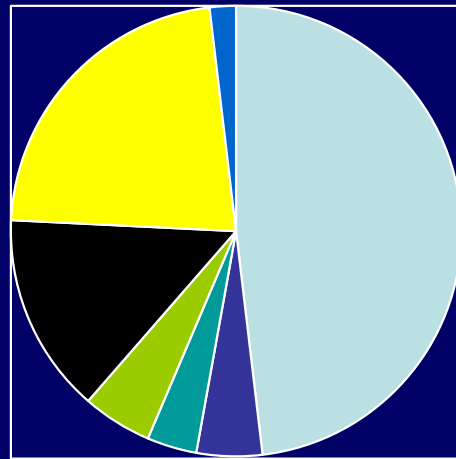


Description	31 March 2007	31 March 2006
	Actual Rm	Actual Rm
<b>Revenue</b>	<b>3,307</b>	<b>2,801</b>
Turnover	3,268	2,773
Cost of Sales	(2,514)	(2,904)
Gross (loss) profit	754	(131)
Operating Expenses	(1,257)	(1,155)
<b>Loss Before Taxation</b>	<b>(501)</b>	<b>(1,291)</b>
Loss After Taxation From Continuing Operations	(507)	(1,311)
<b>Loss for the year</b>	<b>(549)</b>	<b>(1,263)</b>

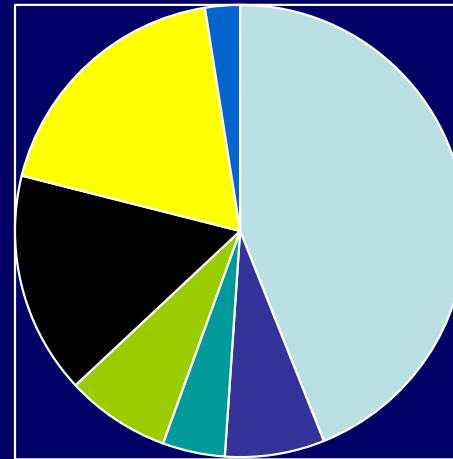
# Sales Per Region



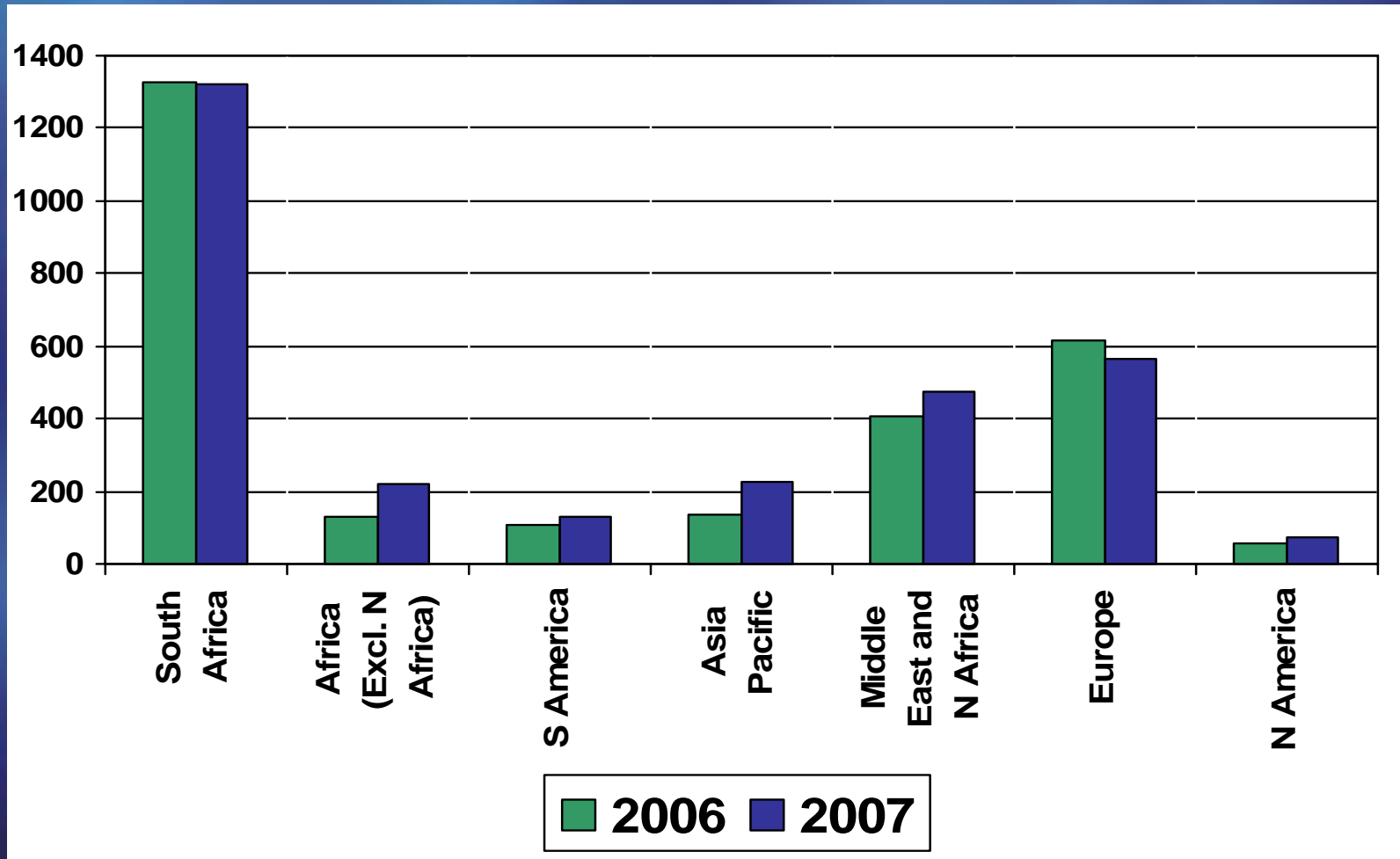
2006



2007



# Sales Per Region

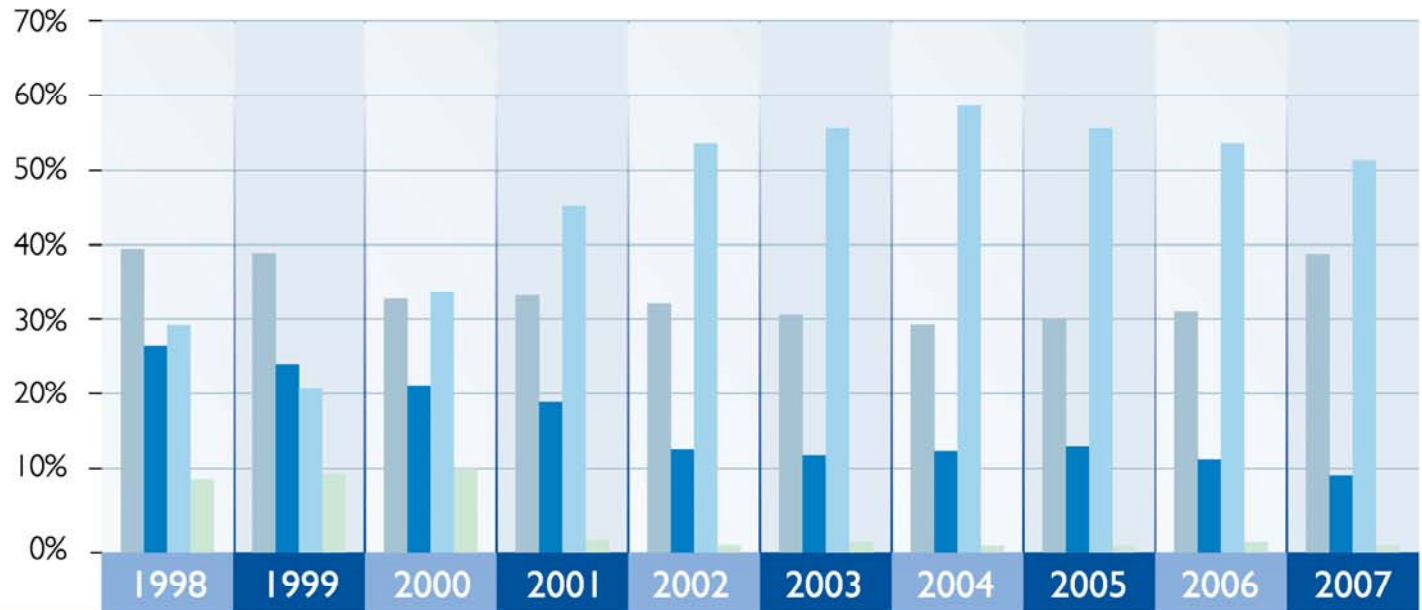


# Group Gross Revenue and Gross Profit / Loss



—■—	Gross revenue	3,177	3,272	3,446	3,621	3,904	4,372	4,442	3,572	2,773	3,268
—●—	Gross profit	700	578	918	826	945	1,276	1,287	231	(131)	754

# Group Gross Revenue Composition (Percentage)



	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Military: Local	39.0	37.2	34.2	34.9	33.0	30.6	27.8	30.0	31.7	38.1
Commercial: Local	25.4	24.1	21.5	17.9	14.0	12.8	13.1	14.6	12.6	8.4
Exports	28.1	30.7	34.8	45.2	52.0	55.6	58.1	54.5	54.3	52.5
Other	7.5	8.1	9.5	2.0	0.9	1.1	1.0	0.9	1.5	1.0

# Group Segment Report



Description	Aerospace		Land Systems		Corporate and Non-cores		Total	
	2007 <i>Rm</i>	2006 <i>Rm</i>	2007 <i>Rm</i>	2006 <i>Rm</i>	2007 <i>Rm</i>	2006 <i>Rm</i>	2007 <i>Rm</i>	2006 <i>Rm</i>
<b>Segment revenue</b>	2,126.9	1,926.0	1,500.4	1,106.4	227.9	311.5	3,268.1	2,773.2
<b>Segment result</b>	(264.7)	(739.9)	(117.2)	(342.1)	0.3	(21.5)	(386.8)	(1,107.2)
<b>Segment assets</b>	1,789.5	1,821.8	1,365.0	1,355.7	6,238.9	7,785.4	4,503.7	4,677.2
<b>Segment liabilities</b>	2,055.5	4,642.5	910.3	1,430.3	3,857.5	3,624.9	3,871.0	4,062.4
<b>Cash flows from:</b>								
Operating activities	(856.7)	(528.6)	(178.2)	(431.6)	3.0	(219.6)	(1,025.8)	(1,146.6)
Investing activities	(87.1)	(81.7)	140.9	(31.3)	(34.5)	200.6	80.3	85.7
Financing activities	(725.6)	466.7	70.3	312.3	(1,712.2)	1,157.1	555.0	1,482.7
<b>Capital expenditure</b>	(55.5)	(88.5)	(37.5)	(31.9)	(27.1)	(19.8)	(120.1)	(140.2)

# Balance Sheet

## – 31<sup>st</sup> March 2007



Description	31 March 2007	31 March 2006
	Actual Rm	Actual Rm
Non-current assets	1,348	1,601
Current assets	2,615	2,724
• <i>Trade and other receivables</i>	1,147	883
• <i>Inventories</i>	1,067	984
<i>Non-current assets held for sale</i>	540	352
<b>Total assets</b>	<b>4,504</b>	<b>4,677</b>
Total equity	633	614
Non-current liabilities	856	2,096
Current liabilities	2,999	1,938
• <i>Trade and other payables</i>	627	561
• <i>Provisions</i>	801	546
<b>Total equity and liabilities</b>	<b>4,504</b>	<b>4,677</b>



# Cash Flow Before Financing Activities

– 31<sup>st</sup> March 2007



Description	31 March 2007	31 March 2006
	Actual Rm	Actual Rm (restated)
Cash utilized in operating activities	(1,015.0)	(1,146.6)
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Cash and cash equivalents at the beginning of the year	730.2	305.5
Cash movement of entities held for sale	(1.3)	2.9
<b>At the end of the year</b>	<b>338.4</b>	<b>730.2</b>

# Total Number of Employees



Description	2007		2006	
	Quantity	%	Quantity	%
<b>TOTAL NUMBER OF EMPLOYEES</b>	<b>7,634</b>	100%	<b>8,120</b>	100%
<b>TOTAL NUMBER OF MANAGERS</b>	<b>493</b>	<b>6%</b>	<b>560</b>	<b>7%</b>
White managers	395	5%	445	5%
Black managers	98	1%	115	1%
<b>RACE</b>				
White employees	3,983	52%	4,266	53%
Black employees	3,651	48%	3,854	47%
<b>GENDER</b>				
Male employees	5,954	78%	6,291	77%
Female employees	1,680	22%	1,829	23%

# Determination of Denel GCEO, EXCO & Entity CEO's Remuneration



- Remuneration of the GCEO is agreed upon during engagement between the Shareholder, Board of Directors and the Group CEO
- Remuneration of EXCO and Entity CEO's is agreed upon during engagement between the GCEO representing the Shareholder, entity Board of Directors/and Denel Board of Directors and the incumbent

The following factors are taken into account:

- GCEO--Size of SOE linked to total guaranteed package as set out in remuneration model as supplied by Public Enterprises
- CEO's and EXCO--Size of the individual company based on salary & wage bill as well as pre-tax profits in line with remuneration principles.
- Market remuneration information as conducted through various surveys is used as an input.
- Remuneration approved in terms of the Denel Delegation of Authority by Shareholder and Board/s of Directors.

# Incentive Bonus Scheme



- An incentive bonus scheme has been introduced for all employees with effect of 1 April 2007
- The scheme encompasses a variable pay portion based on the achievement of agreed upon targets
- In line with best practice, the incentive scheme forms part of employees total remuneration incorporating the pay at risk principle.
- A performance management system has been introduced to link performance to pay.



# Transformation



- Significant progress has been made since the last report in 2006
- A Transformation portfolio/office has been instituted and an executive appointed
- A Transformation framework has been drawn-up and approved
- The Transformation framework and rollout plan has been submitted to all business entities
- A request has been made for business entities to appoint Transformation Champions
- Transformation Committees have been established at the business entities. These committees incorporate CEOs, management, organised labour, non-unionised labour and HR facilitators
- Comprehensive transformation plans have been drawn-up and approved by the Group CEO.
- Progress evaluation and performance reporting are scheduled for Nov 2007 and Mar/Apr 2008 respectively.

# Socio-Economic Development



- Denel Centre for Learning and Development (DCLD)
  - Partnering strategy adopted with industry and other SOEs
  - Apprentice school expanded to include non-aerospace trades
  - 5-year contract signed with Eskom to train 100 apprentices per year
  - The DCLD thus contributes meaningfully to JIPSA and 70% of the intake are women
- Denel Youth Foundation Training Programme (DYFTP)
  - The Programme currently has 295 learners from all over the country
  - Learners are sponsored by the DoD, Transnet, Eskom, Denel, and the DPE.
  - Learners must show an interest in careers in science, engineering and technology
  - Extensive schooling is given in mathematics and science.

# Socio-Economic Development



- Schools Outreach Programme (SOP)
  - Covers grade 11 and 12 learners in all nine provinces
  - 93% pass rate with 65% having university entrance
  - Nominated as the best run project in the North West by the Provincial Dept of Education
  - Denel's contribution for the past year amounted to R1.2 million
- Apprentice and Artisan Training School
  - Part of the company's strategy to build its skills base
  - The School covers apprentice and artisan training as well as trade test preparation and revision
  - There are 253 students for 2007, including private and foreign students
  - 189 males, 64 females.



# BEE Performance



	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
Procurement (Actual) Rm	1,463.0	1,185.0	1,397.0	1,985.0	1,794.0	1,811.1
Planned BEE Procurement Rm	*	*	*	427.0	469.7	308.9
Actual BEE Procurement Rm	166.2	251.1	201.9	437.1	334.2	380.1
Planned BEE Procurement (%)				21.5	26.1	17.1
Actual BEE Procurement (%)	11.4	21.2	14.5	22.0	18.6	21.0

\* Figures were not captured





# Risk Governance Summarised



# PFMA



## - Treasury Regulation 27.2.1

- Requires that the accounting authority carry out regular risk assessment and have a risk management strategy in place
  - A formal risk management process is in place, which includes a fraud prevention policy but the policy was not fully implemented. The policy has been implemented subsequent to the year-end audit and a fraud response plan was approved by the Board Audit and Risk Committee on 9 October 2007 for implementation.



# PFMA

## – Sec 51(1)(a)(i)



- Requires an entity to maintain an effective system of internal financial control
  - Deficiencies were identified in two business entities
  - Action plans have been implemented to address these deficiencies
  - Internal audit has been outsourced to PWC.



# PFMA

## – Sec 51 and 55 of the PFMA

- Requires the prevention, identification and reporting of irregular and/or fruitless and wasteful expenditure
  - Certain penalties were incurred which could be deemed as wasteful expenditure
  - The Board examined these issues and is satisfied that they were not incurred in vain
  - Internal control system has been strengthened.



# Companies Act



- Instances of non-compliance at certain subsidiaries occurred which ranged from:
  - Company registers not being kept up to date
  - Annual returns not being submitted
  - No AGMs being held
  - No resolutions passed to approve annual financial statements
- The majority of these issues have been rectified subsequent to the year-end.



- **Background**
- **Strategy Update**
- **Business Unit Status**
- **Year-End Results**
- **Order Pipeline and General Progress**
- **Annual Report**
- **Conclusion**



# Conclusion



- Turnaround strategy on track
- Forward sales focus starting to bear fruit
- Relationship between stakeholders improving
- Armscor unbundling and DERI process has a potential impact on momentum
- Denel's view is that SADRI should consolidate further
- Visibility of certain procurement budgets not clear from DOD/Armscor, impacting on ability to plan business activities.





**Thank you**



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