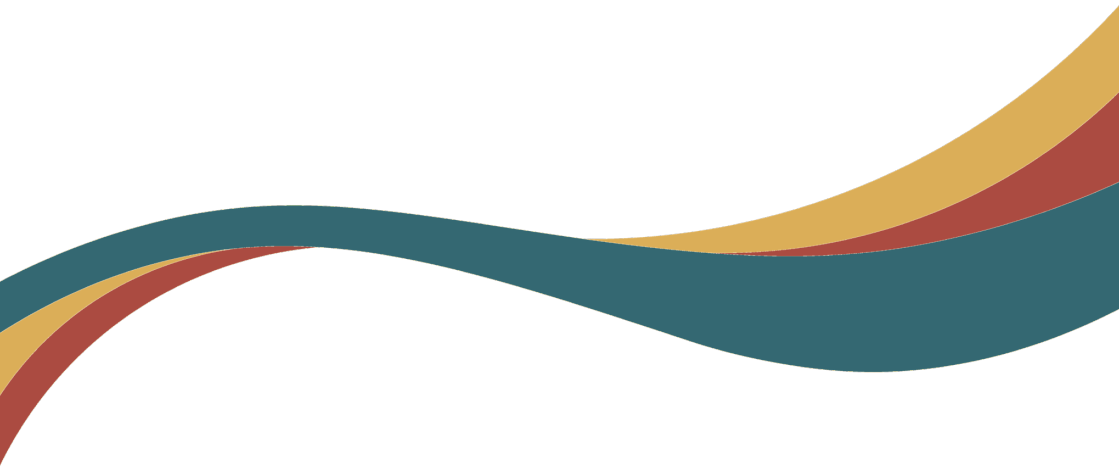




# CONTRACT FINANCE DEBT FUND





## FUND MANAGER



## FUND ADVISORY COUNCIL INCLUDE -



## ADVISORS



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**DIF**

DEFENCE INDUSTRY FUND

## INTRODUCTION

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The ability to provide the requisite defence equipment and services depends on the existence of a vibrant and competitive defence industry, comprising of local and international companies. Such an industry is seen as an integral part of the SANDF's capabilities and, in return, the industry views the SANDF as an anchor client. From an SA broader economic and trade point, point of view, there is a set of national imperatives that range from localisation to transformation and SMME development as well as strategic partnerships with international suppliers. All these imperatives are geared towards ensuring future sustainability of the SA Defence Industry (SADI). Furthermore, new entrants into the defence industry will have to be introduced for future sustainability

## CURRENT CHALLENGES

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Given the complexity and high cost of the defence material and equipment, the barriers of entry into the industry are high, which results in long-term single-source contracting and over-dependence on international suppliers, even in critical and sovereign capabilities.

## THE NEED FOR THE DIF

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- Grant access to finance for both existing and prospective defence companies
- Attract a wider pool of investors including local and international funding sources e.g. private funders and institutional investors
- Give access to support services, tools and support to keep the business running
- Provision of technical skills
- Job creation and skills transfer spinoff

## NATIONAL RISK CONSIDERATION

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The dependence of the Defence Force on foreign-sourced equipment, munitions, spares and technical support will curtail South Africa's strategic independence, freedom of strategic action and, to an extent, places sovereignty at risk.



## DEBT FUND - OVERVIEW

Target Fund Size	R1 bn
Target Return	CPI plus 8%
Performance Hurdle	R186 GOVI
Deployment Period	24 Months
Fund Life	Open-Ended
Fund Structure	En Commandite Partnership (Open- Ended)
Type of Investment	Debt
Max Loan Size	R 50 000 000
Types of Investments	<ul style="list-style-type: none"><li>• Contract (Project) Finance</li><li>- Secured offtake from DOD</li><li>- Clear payment terms</li></ul>
Loan Tenors	Min 1 Month Max 36 Months
Liquidity	Self-Liquidating Instruments
Commitment Period	Min 3 Years

## INVESTMENT RATIONALE

- SANDF (Armcor/Department of Defence) to act as anchor client for contracts and provide payment security to the Fund
- Fund Manager to support Armcor to reach B-BBEE procurement targets by providing financing to Black-Owned and Empowered SMEs.
- Department of Defence (DOD) current spend in excess of R12 bn on goods and services per annum.
- Armcor (2016/17) BEE acquisition procurement shortfall of R2.4 bn presents a good opportunity for the Fund to close the gap.
- Credit Enhancement Mandate Rules established to protect the Fund against non- payment and/or non-delivery.



# THE OPPORTUNITY - ARMSCOR

4,000



Number of suppliers in the Department of Defence (DOD) Database

200



Average number of contracts awarded annually with deliverables below 12 months

600



active SME suppliers in DOD Database

## Security of Payment



Contracts placed only once funds have been made available. Funds are ring-fenced once contract is placed for that particular contract

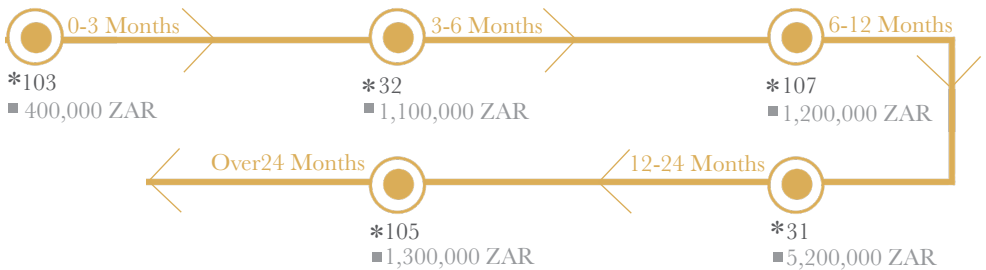
98%

paid suppliers within 30 days or less

### KEY:

- \* Number of SME Suppliers
- Average Contract Value

### Contract Duration



Source: SMEs Armscor



As per table below, an amount of at least R12.5 billion in expenditure is spent annually by the DOD on goods and services such as - computer services, contractors, operating leases, property payments and inventory. This presents a sizeable market opportunity for SMEs in Defence and Defence Related Industries. The Fund will look to provide financial support to SMEs to enable them to finance and deliver on these contracts.

	2018/19	2019/20	2020/21
R million	Total	Total	Total
<b>MTEF Allocation</b>			
Compensation of Employees	27 116.7	29 193.7	31 365.9
Goods and Services	12 330.8	12 927.8	13 745.9
Transfers and Subsidies	7 614.4	7 701.7	7 980.6
Payment for Capital Assets	887.8	873	906.8
<b>Total</b>	<b>47 949.7</b>	<b>50 696.2</b>	<b>53 999.3</b>

Table: Economic Classification - Current Medium Term Framework Budget: 2014 – 2019

### PROCUREMENT TARGETS - ARMSCOR

In summary, in the 2016/17 financial period, Armscor spent 7.52% of the R6bn acquisition budget versus 15% target spend (R907million), 2.65% on EMEs versus a target of 15% (R907 million). The major shortfall is expenditure on Black Owned Entities (BOEs) which came in at R545 million spend versus a target of R2.4 billion.

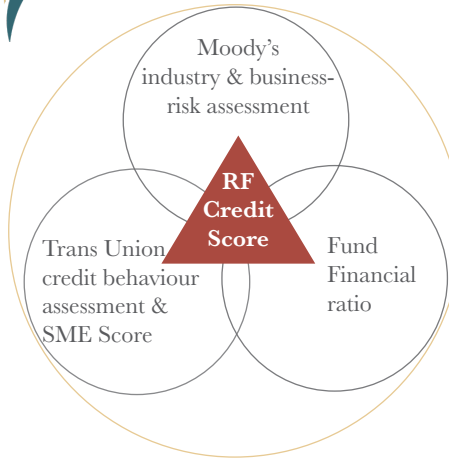
Total Acquisition Procurement Spend	R 6 052 202 067			
Enterprise Classification	B-BBEE SPEND	Current	Target	R Shortfall
QSEs	R 454 916 966	7.52%	15%	(R 452 913 344)
EMEs	R 160 598 984	2.65%	15%	(R 747 231 326)
BOE>51%	R 545 287 006	9.01%	40%	(R 1 875 593 820)
BWOE>30%	R 175 958 381	2.91%	12%	(R 550 305 867)

Table: Target BEE Spend Armscor AFS 2016/17

Fund I and subsequent funds to be launched under DIF will provide financial support to companies with the appropriate technical abilities, track record, teams and empowerment credentials for Armscor to reach its BEE expenditure targets.



## CREDIT EVALUATION PROCESS



Moody's Financial Health Assessment	Considers industry and business-specific data to determine a business's probability of failure
TransUnion's Credit Behaviour Assessment	Considers the credit behaviour of a business and its directors and probability of default
Affordability Assessment	Evaluates a business's credit worthiness based on various affordability ratios & probability of failure based on Altman

Fig: SME Credit Moderation Components

### Post-Loan Monitoring

## DEBT FUND - MANDATE RULES

### Credit Enhancement

(1)	SME must be registered with DOD/Armscor/CSD
(2)	Fund must be the first to receive payment
(3)	SME must have a valid open contract
(4)	Loan amount limited to open contract value
(5)	No previous cancellation due to non-performance
(6)	SME must agree to Biz Support and Monitoring Programme
(7)	Bank receipt account ceded to Fund to receive first payment
(8)	Technical documentation (submitted to DOD/Client) must be submitted to Fund as well
(9)	DOD/Armscor must validate contract and security of payment
(10)	Valid BEE certificate





## INVESTMENT TEAM

### Sandile Sokhela, CFA

Investment Experience	16 years
Qualifications	Chartered Financial Analyst (CFA) MDF (Finance), USB Advanced Tax (Post-Grad)

### Duzi Ndlovu, CFA

Investment Experience	22 years
Qualifications	Chartered Financial Analyst (CFA) MPhil (Applied Ethics), USB

### Greg Hoffman, CA (SA)

Investment Experience	5 years
Qualifications	CA (SA) Post Graduate Diploma: Accounting BBusSc - Finance & Accounting

### Khuselwa Klaas

Investment Experience	8 years
Qualifications	Bcom(Hons) Accounting

### Sean Emery

Credit Committee Member/ CEO of Rainfin

Investment Experience	20 years
Qualifications	BPhys (Witwatersrand University), Post Graduate Diploma: Management - Corporate Finance Elective (WITS Business School)



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