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DDPS - RUAG unbundling concept

Summary of the concept from the Board of Directors of RUAG

1. History

On 21 March 2018, the Federal Council decided to amalgamate the business units which work almost exclusively for the Swiss Armed Forces into a new group company (working name: "RUAG CH – new MRO CH") and unbundle it from the remaining RUAG, which carries out civil and international military business around the world (working name: "RUAG Intl."). The Board of Directors of RUAG Holding AG was tasked with developing a concept to achieve this.

The objectives in view are:

1. To split RUAG into two independent legal entities;
2. To increase IT security;
3. To make service provision for the DDPS robust, transparent and cost-effective;
4. To make it easier for the Federal Council to define expectations of the BoD more precisely and align them with armament policy;
5. To give RUAG Intl. an opportunity to develop third-party business. In the process, options for opening up the shareholder base will also be examined.

The Board of Directors of RUAG Holding AG has developed the concept in conjunction with the owner representatives from the DDPS, the FDF and the FDJP. The Federal Council approved the concept at its meeting of 27 June 2018. In taking this decision, the Federal Council is seeking to increase IT security and ensure robust, transparent and cost-effective provision of services for the Armed Forces. The intention is that RUAG should continue to fulfil its existing statutory purpose – i.e. guaranteeing that the Swiss Armed Forces are well equipped – while at the same time having the opportunity to develop its other business areas further.

2. Content of concept

Demarcation between MRO CH and RUAG Intl.

The concept approved by the Federal Council sets out the key points of the unbundling process. It is, then, possible that more in-depth analyses will lead to adjustments and hence applications for amendments to the Federal Council.

Under the concept, the materials centre of excellence function (MKZ) will almost entirely come under the aegis of MRO CH. This applies to all systems currently covered by service level agreements (SLAs) with RUAG today, as well as to future complex and security-relevant systems of the Swiss Armed Forces, where the original manufacturers are not domiciled in Switzerland (e.g. Pilatus, MOWAG). For noncomplex systems and materials, the MKZ function can continue to be performed by the Armed Forces Logistics Organisation (LBA). Another assignment criterion is the existence of significant third-party business.

In deployment-relevant systems, system maintenance is also performed by MRO CH, in addition to the MKZ function. This preserves the DDPS's sphere of influence. If there is significant third-party component maintenance business or if such business is targeted, the maintenance of these components will be performed by RUAG Intl.

RUAG Intl. will take over the remaining services of what is currently RUAG. Military business will represent only around a 25% share of RUAG Intl.'s business, while most of its employees and infrastructure will be located in Switzerland. Thanks to the civil and external business, there are now reserves which can be used in a crisis situation for the Swiss Armed Forces, which considerably improves robustness. RUAG Intl. has no direct IT connections to DDPS and acts as a normal external company. This IT security gain may come at the expense of a loss of synergies and increased costs.

	Without substantial external business	With substantial external business	
System management/responsibility	**DDPS**		-
System support (MKZ)			e.g. system engineering, technical/commercial reporting, technical/logistical support
System maintenance			e.g. provision of systems, maintenance/diagnostics/fault limitation/repair on the system
Material procurement	**MRO CH**		e.g. procurement of spare parts/resources, inventory and equipment management
Component maintenance		**RUAG Intl.**	e.g. maintenance/overhaul/diagnostics/fault limitation/repair of components
Integration projects			e.g. integration of new components into the systems introduced
OEM projects			e.g. development and production of systems, assemblies, simulators

Note re "system maintenance": at RUAG Intl. applies only to non-security-sensitive systems (e.g. simulators).

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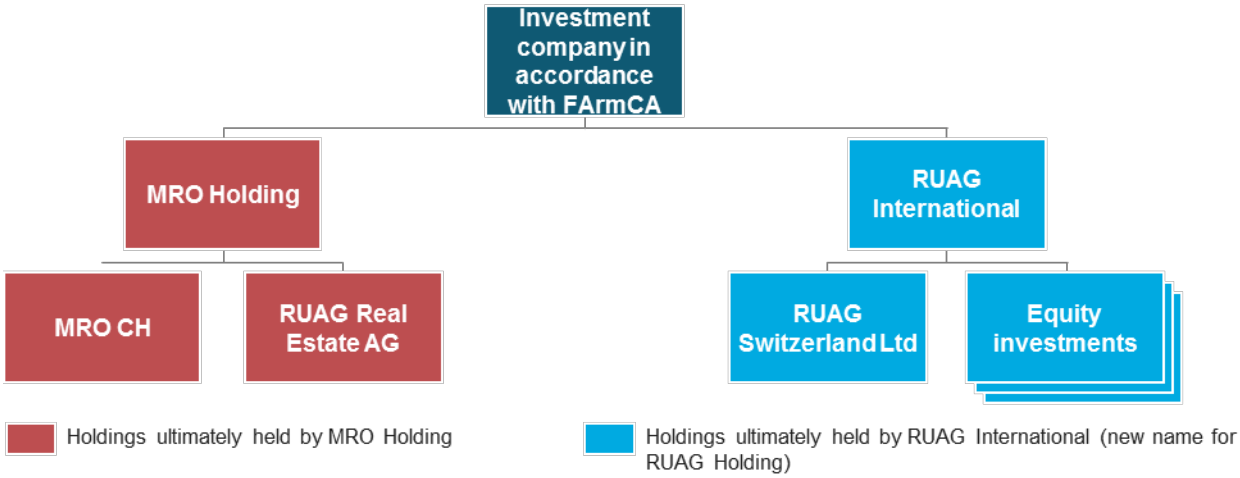
Legal structure



The legal unbundling is based on the separation of the two business units, MRO CH and RUAG Intl. within the RUAG Group. In terms of company law, there are various ways to implement the unbundling. The primary concern is to ensure that there is as little as possible loss of substance for the company as a result of the unbundling. With this requirement in mind, various unbundling options were investigated.

In accordance with Article 3, para. 3 of the Federal Act on Federal Armaments Companies (FArmCA), an investment company in the form of a private limited company will hold all the federal government shares in armaments companies. The creation of two completely separate legal structures, each with their own group parent companies, would therefore have been possible only by way of a change in the law.

The concept proposed to the Federal Council represented the simplest and most sensible option for legal unbundling. It provides for the founding of a new holding company (investment company) by the federal government in accordance with the FArmCA, followed by the demerger of today's RUAG Holding into MRO Holding and RUAG Intl. The MRO Holding company will accommodate MRO CH and RUAG Real Estate only.

Corporate Governance - creation of separate boards of directors

Under Art. 4 para. 1 FArmCA, the Swiss Confederation is represented on the Board of Directors of the investment company in accordance with its interests. Under Art. 4 para. 2 FArmCA, the investment company is also represented on the boards of directors of the armaments companies in accordance with its interests.

One consequence of the unbundling process is the setup of new, separate boards of directors, with a new one needing to be set up for each of MRO Holding and RUAG Intl. The articles of association of MRO Holding and MRO CH are to include the entitlement of the Swiss Confederation to propose a member of the DDPS management for election to the Board of Directors. This solution means that the Armed Forces, as the main customer of MRO CH, are represented on the Board of Directors and can, as required by political considerations, directly influence the company's strategy. It also guarantees the greatest possible transparency for dealings with the DDPS.

3. Further development of the RUAG Group

Further development of MRO CH

The intention is that, after 2020, MRO CH should aim to further expand and preserve its MRZ expertise. In order to do this, MRO CH must be able to guarantee the logistical operational readiness of the systems covered by ongoing contracts until 2022, and also of future systems of the Swiss Armed Forces. This means that MRO CH will be involved in the procurement projects at the earliest possible opportunity. Only in this way will the Group company be able to build up the expertise needed for maintenance.

The Swiss Confederation will continue to be the sole shareholder of the newly founded investment company and will control MRO CH via the associated ownership rights.

Further development of RUAG Intl.

RUAG Intl. has a very broad range and will not be able to further develop its entire portfolio based on its own resources alone. For that reason, RUAG Intl. is looking to streamline its portfolio beyond the year 2020. The financing of the further development of the core areas can either be achieved by selling off areas which do not form part of the core area, or through the capital market. At the same time, at least partial privatisation will have to be investigated, as the business with and for the Swiss Armed Forces still represents 25%, all projects must be fought for based on free competition and most of the company’s business activities are carried out abroad.

Unbundling the IT systems

The unbundling will require the IT systems to be adapted. Two technical options for the IT unbundling are being considered, and the Steering Committee (made up of representatives of RUAG, the DDPS and the FDF) will come to a decision by the end of summer 2018. Both options envisage setting up a separate IT system for MRO CH, Option 1 being outside the security perimeter of the DDPS, and Option 2 within it.

The decision will be taken on the basis of a justified estimate of operating costs, personnel requirements and costs and risks of migration.

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Conclusion

The concept submitted fulfils the objectives:

- The creation of two legal units, MRO CH (under MRO Holding) and RUAG Intl. and separating services based on the principle of the presence of substantial external business results in two legally and operatively independent units under the parent investment company in accordance with BGRB:

- In principle, MRO CH will perform the MKZ function and system maintenance for complex, security-sensitive systems of the Swiss Armed Forces.

- RUAG Intl. will take over the remaining services of what is currently RUAG. MRO Int., for example, will continue also continue to provide services to the Swiss Armed Forces, specifically component maintenance services.

- By separating the IT systems of MRO CH and RUAG Intl., MRO CH will, in future, no longer be exposed to the risks that primarily affect RUAG Intl. The IT requirements of the DDPS are also met in full at MRO CH.

- MRO CH and RUAG Intl. are run by different management teams which are independent from one another.

- MRO CH and RUAG Intl. have completely separate financial management systems, which are therefore independent of one another.

4. Preliminary schedule for unbundling

The schedule anticipates an operative golive on 1 January 2020. By this point at the latest, employees should be managed within the new structure, reporting (budget, planning, profit and loss and balance sheet) should be managed within the new structure and the unbundling of the IT systems should be complete. As a result, MRO CH and RUAG Intl. will be operated as independent companies by 1 January 2020 at the latest, and the IT security requirements will be fulfilled in accordance with the DDPS's preferences for the unbundling.

The Board of Directors of RUAG Holding AG will submit a detailed plan for implementation of the unbundling to the DDPS by the end of 2018 at the latest. The DDPS will review this plan in cooperation with the FDF (FFA) and submit the necessary decisions on the reorganisation of RUAG to the Federal Council by the end of March 2019.