Transnet

Briefing to the Portfolio Committee on the 2018/19 Integrated report and AFS

2018/19 Performance highlights – media press release

- ✓ Revenue increased by 1,6% to R74,1 billion, supported by a 9,1% increase in petroleum volumes.
- ✓ Net profit for the year increased by 24,7% to R6,0 billion (2018: R4,9 billion).
- ✓ Capital investment of R17,9 billion, brought expenditure over the past seven years to R183,5 billion.
- ✓ Operating expenses decreased by 0,1% to R40,3 billion.
- ✓ Savings of R6,8 billion were achieved against planned costs.
- ✓ Gearing of 44,5% and cash interest cover at 2,9 times – within loan covenant requirements.
- ✓ 2,5% of personnel costs invested in training, focusing on:
  - Artisans;
  - Engineers; and
  - Technicians.
- ✓ EBITDA increased by 3,8% to R33,8 billion, with the EBITDA margin increasing from 44,6% to 45,6%.
- ✓ Cash generated from operations increased by 0,7% to R35,2 billion.

Qualified external audit opinion

- The 2017/18 AFS were qualified on the basis that external audit was unable to obtain sufficient appropriate audit evidence that the disclosed irregular expenditure was "complete and accurate", primarily due to the lack of implementation of controls, and monitoring of existing controls, to identify and report on irregular expenditure.
- Management made a significant effort to improve and establish adequate controls to maintain complete and accurate records of irregular expenditure. The vast majority of the irregular expenditure reported in the current year relates to contracts entered into in prior years, which is indicative of the improvement in the procurement control environment that is now preventing new incidences of non-compliance.
- The amount of irregular expenditure reported in the current year is significant due to the expected inclusion of R41,5 billion expenditure on locomotive contracts, entered into prior to 2015, that was the subject of several investigations at the time of finalising the prior year report.
- Despite the above corrective actions, the external auditors have expressed the view, that Transnet's application of certain of the Preferential Procurement Regulations, 2017 relating to tender pre-qualification criteria was inconsistent with the legislation. Although the Company ceased using the tender pre-qualification criteria in June 2018, management did not consider the affected expenditure as constituting irregular expenditure as denoted in the audit finding, as the use of the tender pre-qualification criteria aimed to assist the Company to achieve the competitive supplier development targets set by the shareholder.
- This matter has since been considered in detail and, after input from various technical and legal experts it appears that there are divergent views on whether expenditure arising from tenders containing the pre-qualification criteria, should indeed be interpreted as irregular, as defined by the PFMA. This matter is still under investigation.
- Ultimately, however, the Company was not in a position to satisfy external audit that the reporting of this category of irregular expenditure is complete and accurate and, accordingly, the external auditors have issued a qualified opinion that is specific to the completeness and accuracy of the reported irregular expenditure, as required by the PFMA.
- The qualified opinion is not related to compliance with International Financial Reporting Standards (IFRS) nor the Companies Act of South Africa, 2008.

Financial performance

Performance against 2018/19 Shareholder's Compact

Shareholder's Compact

Financial Sustainability 86%

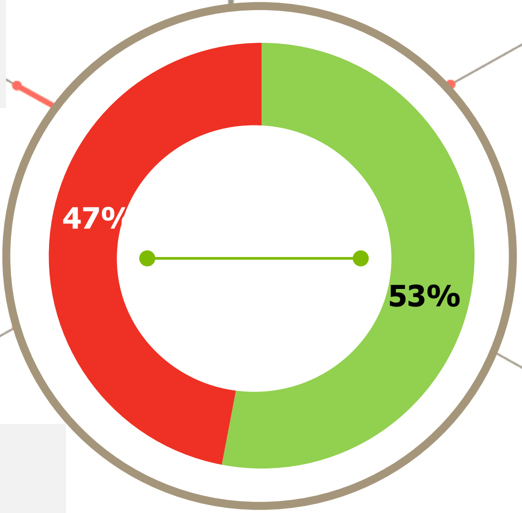
Annexure A: Financial Sustainability (25%)
- 6 of the 7 KPI targets were achieved

Industrialisation 60%

Annexure E: Industrialisation (15%)
- 9 of the 15 KPI targets were achieved.
- Underperforming KPIs were largely influenced by the change in reporting methodology following the outcome of the previous audit.

Socio Economic Development Outcomes 59%

Annexure D: Socio Economic Development Outcomes (25%)
- 10 of the 17 KPIs were achieved.
- A shortage of staff in community centers and procurement delays have contributed to the targeted number of beneficiaries receiving services at community centers not being achieved.



Percentage achievement against 2018/19 Shareholder's Compact

Achieved
Not achieved

Capacity Creation 51%

Annexure B : Capacity Creation (15%)
- 18 of the 35 milestones in this annexure were achieved.
- Projects that have not met their targeted milestones include Coal 81, NMPP, Manganese Rail Phase two, Manganese port (Ngqura) and the acquisition of 1064 new locomotives.
- Manganese milestones were not met due to the programme being placed on hold pending approval of a multi-channel strategy that will achieve the same capacity with a substantial saving in capital cost.
- The delay in 1064 locomotive production is due to delays in the production by both BT and CNR in Durban.

Operational Excellence 36%

Annexure C: Operational Excellence (20%)
- 10 of the 28 KPIs were achieved in this annexure.
- The underperformance is due to internal and external factors. External factors contributed 52% of the 19,87mt deviation from the target for the 2018/19FY.
- Ports efficiency measures for container moves per ship working hour, ship turnaround time and anchorage waiting were largely impacted by equipment breakdowns experienced in operations.

Financial performance

March 2019 R million		March 2019 vs Corporate Plan	March 2019 vs Prior year
74 070	Revenue **	(11,3%)	+1,6%
33 750	EBITDA **	(7,2%)	+3,8%
(2 688)	Impairment	>100 %	+86,4%
3 271	Fair value adjustments	>100%	>100%
6 047	Net profit	+2,2%	+24,7%
17 941	Capital investment	(30,0%)	(17,6%)
2,9	Cash interest cover *#	+0,4	(0,1)
44,5	Gearing*	+1,0%	+1,1%
35 165	Cash generated from operations	(3,6%)	+0,7%

* *Absolute variance.*

\# *(Times) excluding working capital changes.*

** *Claw back accounting was discontinued in the current financial period in terms of IFRS15.*

Revenue for the year increased by 1,6% to R74,1 billion (2018: R72,9 billion), supported by a 9,1% increase in petroleum volumes. The increase in petroleum volumes is mainly due to the operationalisation of TM2.

Operating costs decreased by 0,1% to R40,3 billion, (2018: R40,4 billion) despite increases of 16,6% in fuel costs; and 3,1% in electricity costs.

Impairment of assets, amounting to R2,7 billion (2018: R1,4 billion), is primarily due to the impairment of property, plant and equipment, resulting from derailments and index valuations on port operating assets, and impairments on trade and other receivables.

Fair value adjustments amounted to a R3,3 billion gain (2018: R410 million gain) and are mainly due to TNPA investment property fair value gains of R3,2 billion, as well as the fair value gains on interest rate swaps due to the upward shift in the forward interest rate curves.

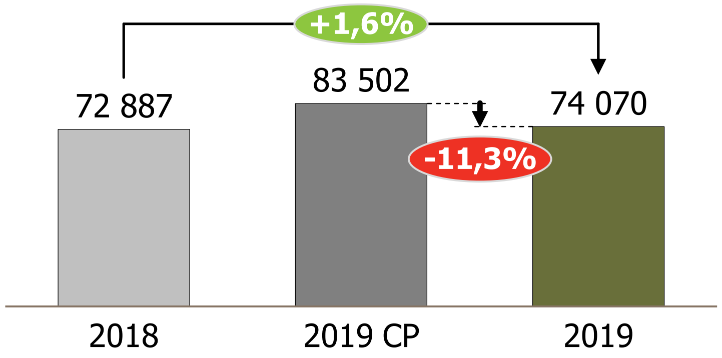
Capital investments decreased due to optimisation of capital projects.

The cash interest cover ratio at 2,9 times reflects Transnet’s strong cash-generating capability.

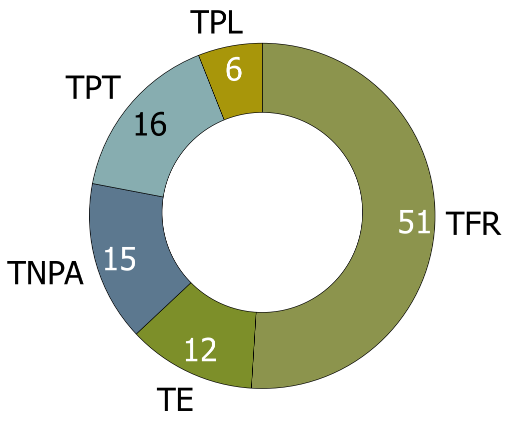
Gearing increased to 44,5% (March 2018: 43,4%), mainly due to the R25,9 billion asset devaluation in the current year.

Volumes and revenue

Revenue (R million)

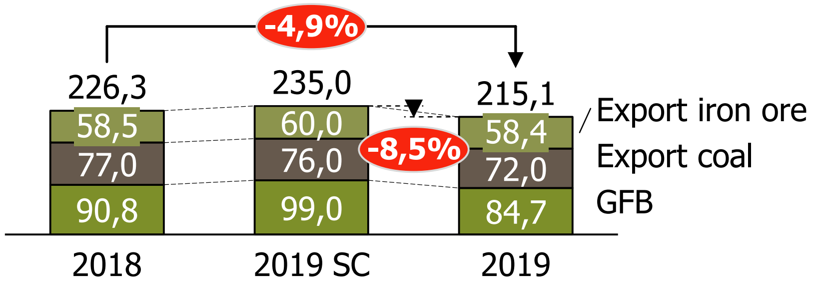


Revenue contribution by core Operating Division (%)**

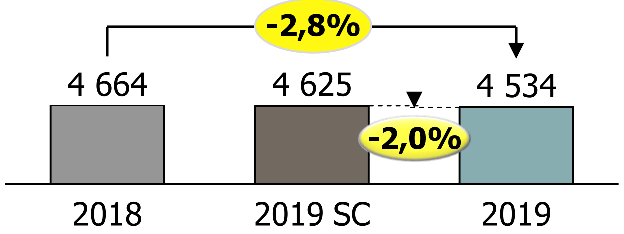


*** Excludes specialist units and intercompany eliminations.*

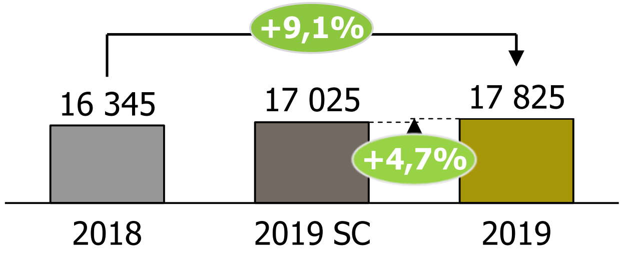
Rail volumes (mt)



Port containers ('000 TEUs)

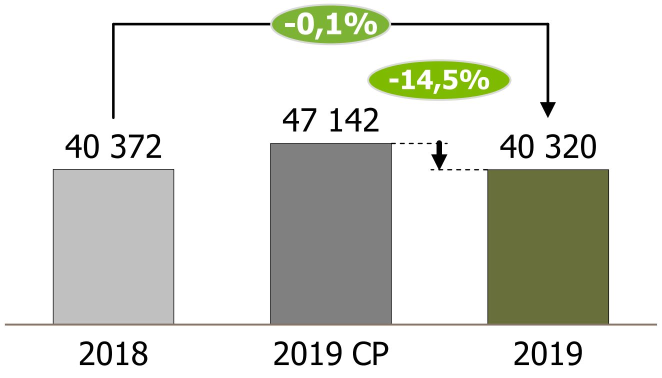


Petroleum (mℓ)

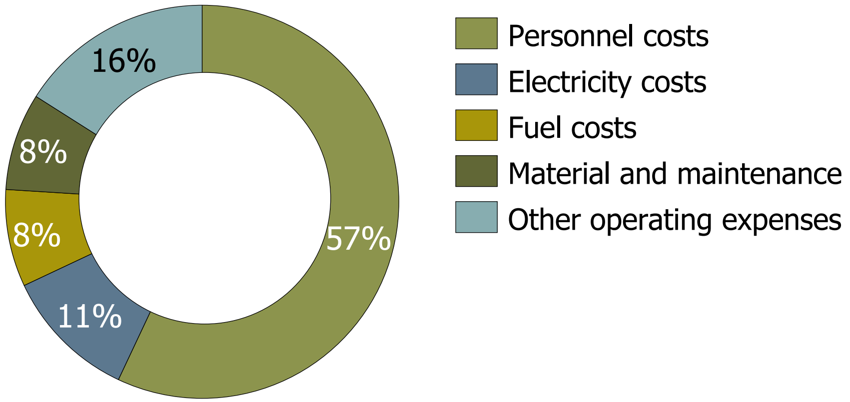


Net operating expenses

Net operating expenses (R million)



Net operating expenses contribution by cost element (%)



Net operating expenses

Net operating expenses decreased marginally by 0,1% to R40,3 billion (2018: R40,4 billion) despite increases of 16,6% in fuel costs and 3,1% in electricity costs.

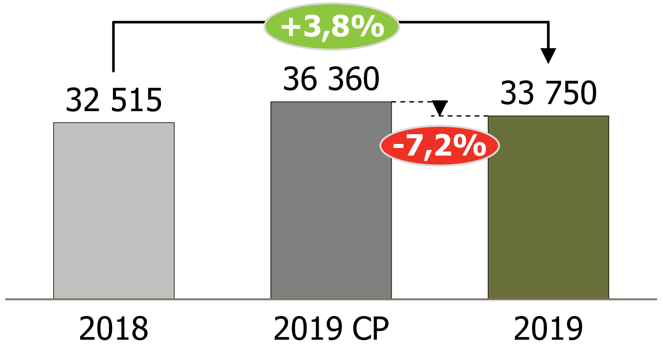
Cost-optimisation initiatives

- Rationalising overtime, reducing professional and consulting fees;
- Rolling out programmes to measure condition-assessment versus time-based maintenance execution; and
- Limiting discretionary costs relating to travel, printing, stationery and telecommunications.

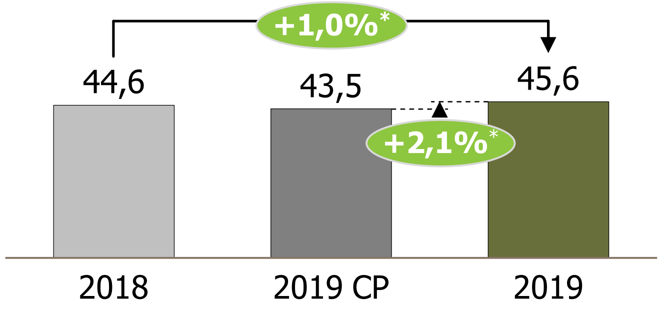
R6,8 billion savings against planned costs

EBITDA

EBITDA (R million)

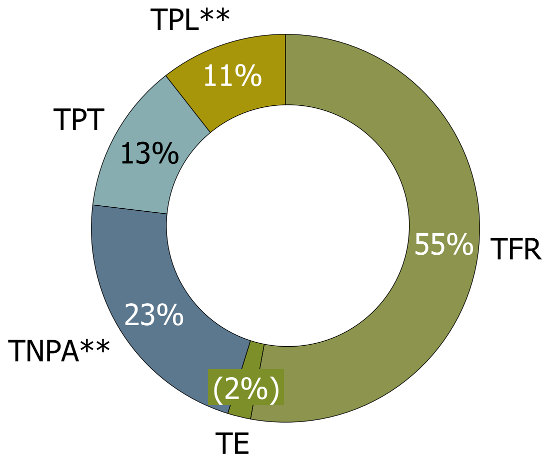


EBITDA margin (%)



** Absolute variance.*

EBITDA contribution from core Operating divisions (R million)

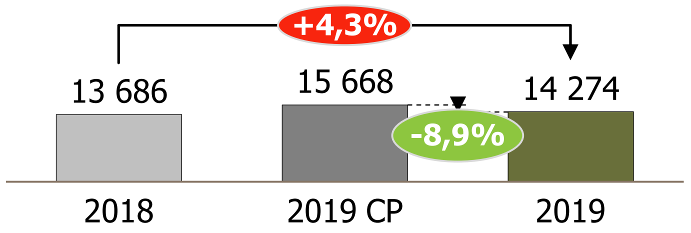


Regulated entities **represent 34%** of Group **EBITDA**

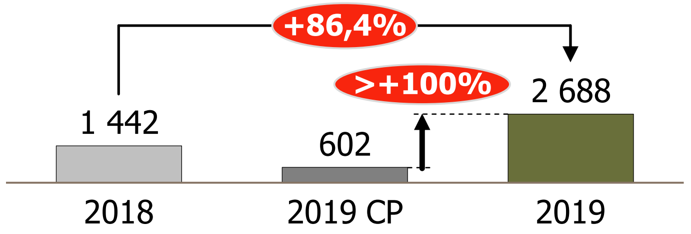
*** Regulated entities.*

Depreciation, impairment, fair value adjustments and finance costs

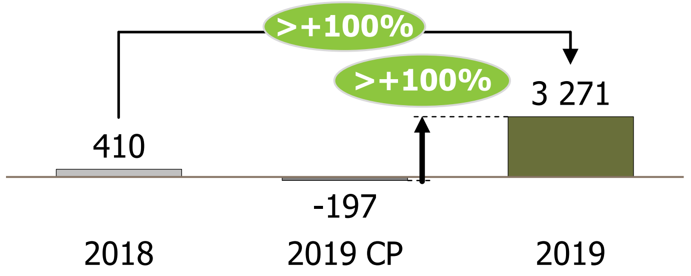
Depreciation, derecognition and amortisation (R million)



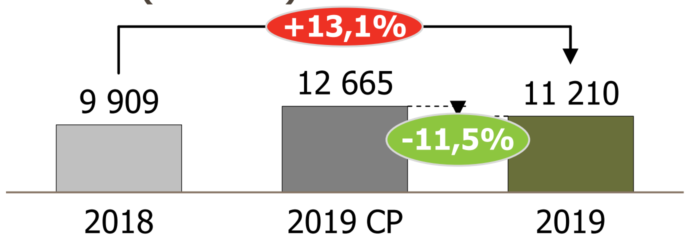
Impairment of assets (R million)



Fair value adjustments (R million)



Net finance costs (R million)



Depreciation, derecognition and amortisation of assets increased by 4,3%, primarily due to:

- The revaluation of rail and port infrastructure in the prior year; and
- The operationalisation of TM1 tightlining (August 2017) and TM2 accumulation facility (December 2017) in the prior year.

Impairment of assets of R2,7 billion mainly due to:

- The impairment of property, plant and equipment (derailments and index valuation impairments on port operating assets).
- Impairments on trade and other receivables.

Fair value adjustments amounted to a R3,3 billion gain (2018: R410 million gain) are mainly due to investment property fair value gains of R3,2 billion, mainly:

- R2,715 billion recorded at TNPA;
- R413 million recorded at TFR ; and
- R32 million recorded at TP.

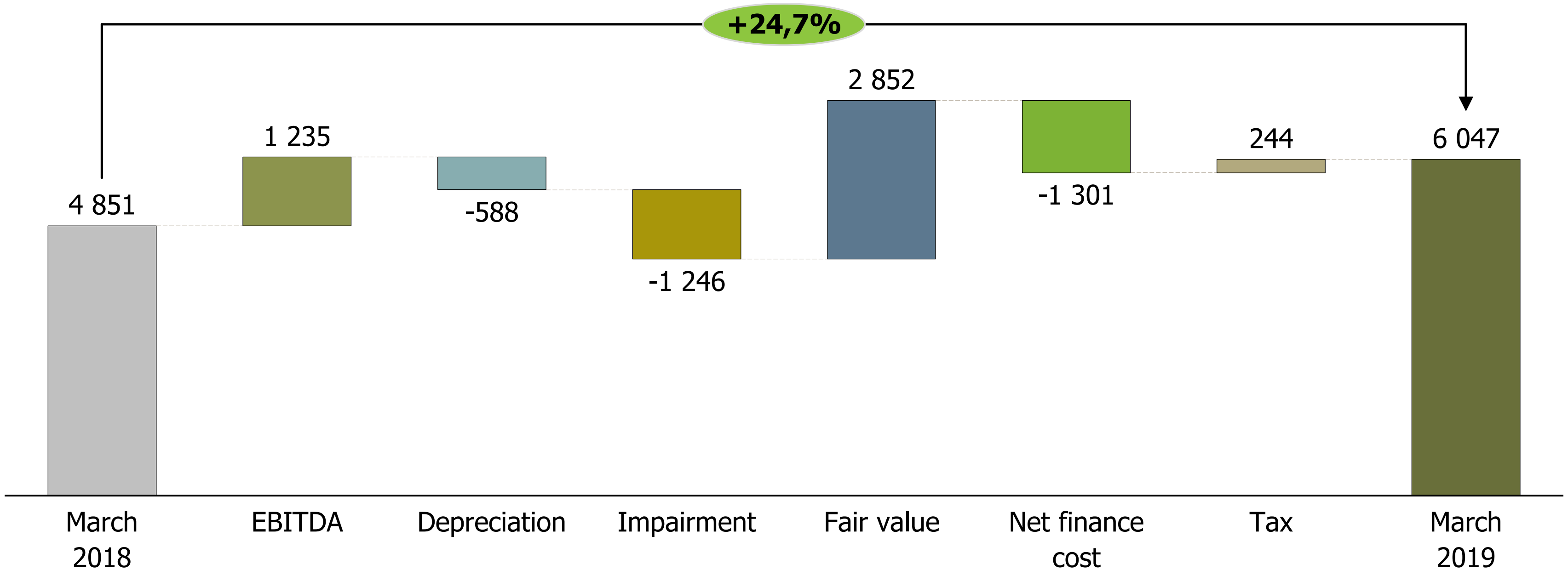
Fair value gains on interest rate swaps resulted from the impact of the upward shift in the forward interest rate curves.

Net finance costs increased by 13,1%, mainly as a result of:

- Lower capitalisation of borrowing costs compared to the prior year of R1,3 billion due to the commissioning of the TM1 and TM2 accumulation facility in the prior year; and
- An increase in the weighted average cost of debt as a result of the credit rating downgrades in December 2017.
- The saving against plan is due to lower than expected new debt as a result of lower borrowings aligned to optimised capital investment.

Net profit for the year

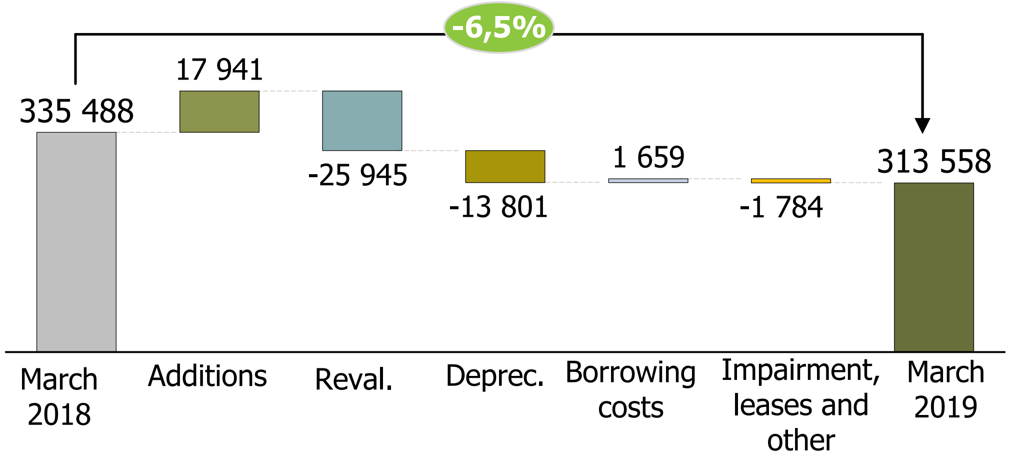
Net profit for the year (R million)



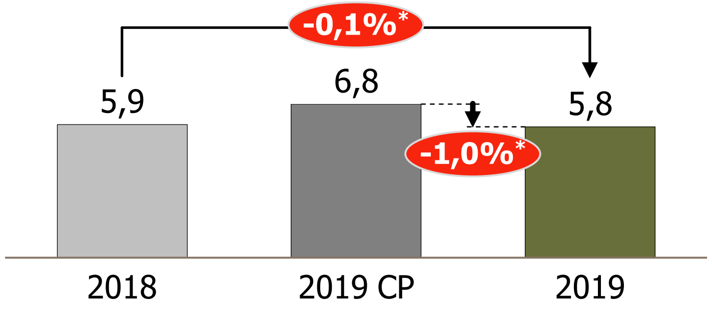
Net profit for the year increased by 24,7% mainly due to a 3,8% increase in EBITDA and a R3,3 billion fair value gain (primarily attributable to TNPA investment property), partially offset by increases in depreciation, impairments, finance costs (due to credit rating downgrade in November 2017 and interest rate swaps) and tax.

Property, plant and equipment

Property, plant and equipment (R million)



Return on total average assets (%)[1]



(1) Excluding capital work in progress and Regulator claw backs.
**   Absolute variance.*

PPE decreased by **6,5%** to **R313,6 billion** mainly as a result of the net devaluation of R25,9 billion:

- Rail infrastructure devaluation of R23,2 billion;
- Port infrastructure devaluation of R3,6 billion;
- Land, buildings and structures revaluation of R140 million; and
- Pipeline networks revaluation of R698 million.

This was partially offset by the capital investment of **R17,9 billion**.

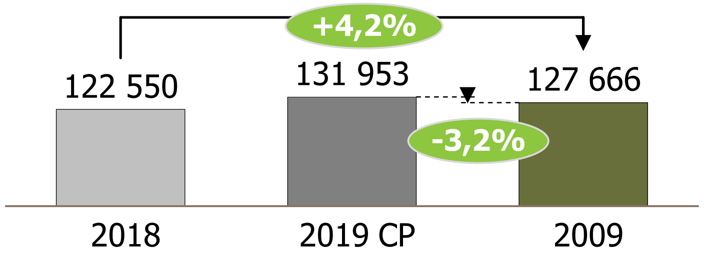
- Expansion: R3,2 billion.
- Sustaining: R14,7 billion.

Return on total average assets = **5,8%.**

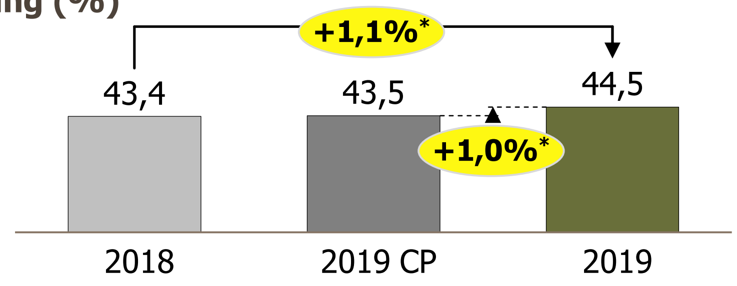
- Represents a marginal decrease of **0,1%** compared to the prior year.

Total borrowings and cash interest cover

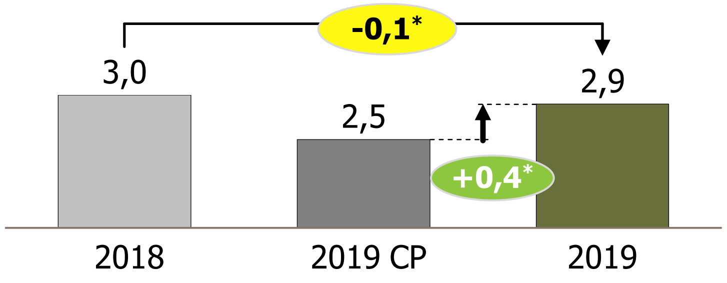
Total borrowings (R million)



Gearing (%)



Cash interest cover (times)**



** Absolute variance.*
*** Excludes working capital changes.*

Total borrowings increased by 4,2% mainly due to the translation of foreign currency debt, which is offset by a compensating increase in derivative financial assets (foreign currency exposure is fully hedged).

The gearing ratio increased by **1,1%**.

- Below the target range of <50,0%.
- Below the triggers in loan covenants.

The gearing ratio is not expected to exceed the target ratio over the medium-term.

Transnet's **stable cash-generating capability** resulting in a cash interest cover of 2,9 times is **well within the triggers** in loan covenants.

Abridged Group cash flows

	Mar 19 Actual R million	Mar 19 Budget R million	Mar 18 Actual R million	% var to Budget
Cash flows from operating activities	21 930	21 215	22 958	3,4
Cash generated from operations	35 165	36 460	34 915	(3,6)
Changes in working capital	(1 633)	(2 320)	(2 161)	(29,6)
Other operating activities	(11 602)	(12 925)	(9 796)	(10,2)
Cash flows utilised in investing activities	(20 124)	(28 073)	(24 891)	(28,3)
Cash flows utilised in financing activities	(2 030)	6 852	(109)	>(100,0)
Net decrease in cash and cash equivalents	(224)	(6)	(2 042)	>100,0
Cash and cash equivalents at the beginning of the year	4 380	5 104	6 422	(14,2)
Cash and cash equivalents at the end of the year	**4 156**	**5 098**	**4 380**	**(18,5)**

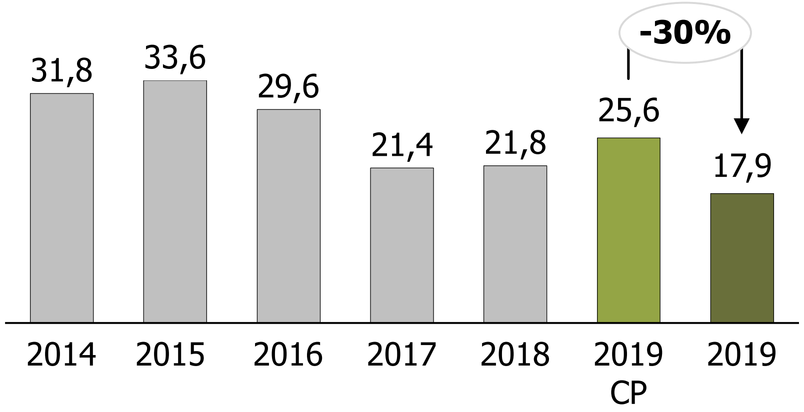
Borrowings raised	**March 2019 R billion**
ICBC	4,0
Commercial paper	0,2
AfDB loan	0,5
CDB	1,5
Total long-term borrowings raised	**6,2**

Credit rating	Moody's	S&P Global Ratings
Foreign currency	Baa3/stable outlook	BB/stable outlook
Local currency	Baa3/P-3/stable outlook	BB+/stable outlook
SACP/BCA	baa3/stable outlook	bbb- stable outlook

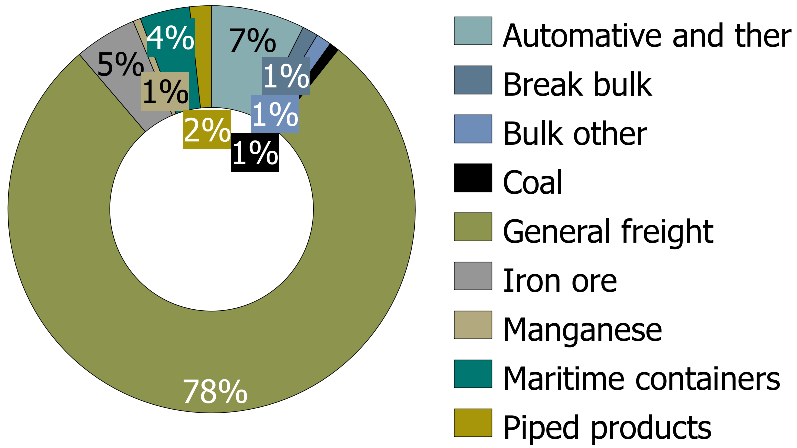
Capital investment analysis

Capital investment analysis

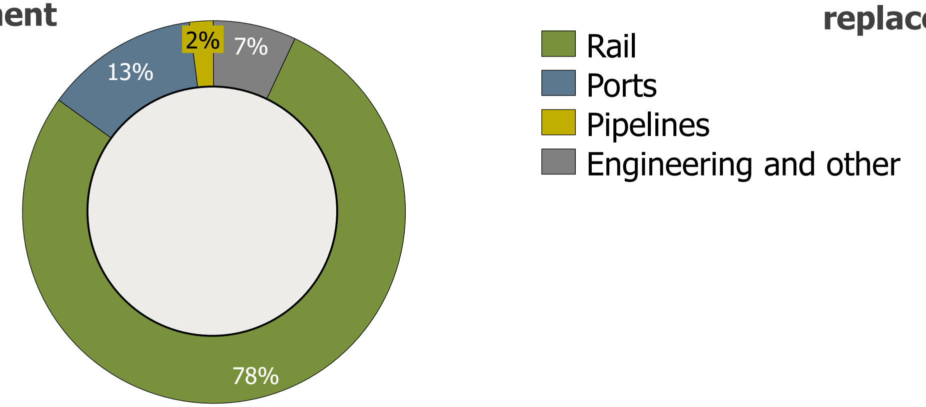
Capital investment
(R billion)



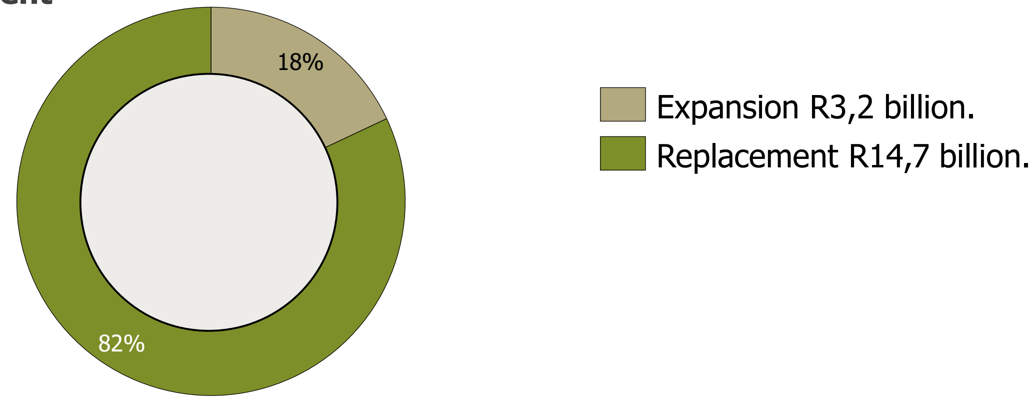
Capital investment by commodity



Capital investment by operating segment



Expansion vs replacement



Although capital investment has declined, the objective of providing capacity aligned to validated demand has been achieved, with R183,5 billion invested over the past 7 years.

TRANSNET

Major capital deliveries

Locomotives accepted (units)	Locomotives accepted March 2019	Locomotives accepted since inception*
232 class 45 diesel	0	21
233 class 44 diesel	30	233
240 class 23 electric	27	37
359 class 22 electric	66	234
Total	**123**	**525**

Wagons	Actual delivery March 2019 (units)
GFB	169
Iron ore	318
Total	**487**

Rail refurbishment - infrastructure	
Turnouts (units)	48
Universals (units)	71
Rails (kilometers)	140
Screening (kilometers)	117
Sleepers (units)	225 783

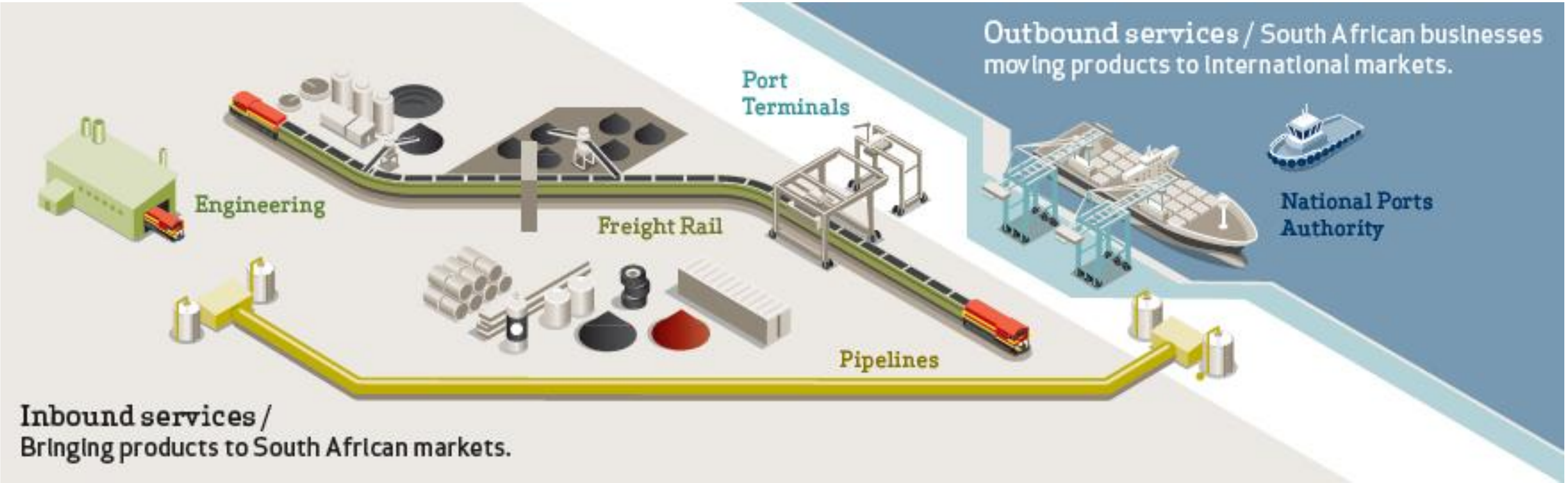
Asset type	March 2019
Port equipment	
Haulers	18
Empty container handlers	10
Rail mounted gantry	1
Excavators	10
Cherry pickers	1
Forklift	6
Survey craft	1
Rail infrastructure	
Coal 81 mtpa	83,7%
Waterberg expansion (revised stage 2-3)	19,5%
Port infrastructure	
Export iron ore sustainability (SLD tippler 3)	64%
DCT berth deepening	Commenced execution
Pipeline infrastructure	
New multi-product pipeline phase 1a	Full multi-product operation

Volumes and operations

Volumes and operations: summary volume performance

2018	2019 CP Target	2019		
58,5mt	60,0mt	58,4mt	↓	Export iron ore volumes railed
90,8mt	99,0mt	84,7mt	↓	General freight volumes railed
77,0mt	76,0mt	72,0mt	↓	Export coal volumes railed
10,0 days	9,5 days	9,7 days	↓	GFB wagon turnaround time

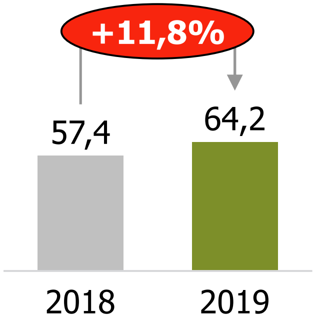
2018	2019 CP Target	2019		
4,663,888 TEUs	4,625,000 TEUs	4,534,341 TEUs	↓	Container volumes at ports
83,1mt	86,5mt	82,4mt	↓	Bulk volumes at ports
704 052 units	725 401 units	743 350 units	↑	Automotive volumes at ports
16 345 Mℓ	17 025 Mℓ	17 825 Mℓ	↑	Pipelines petroleum volumes



Operational efficiencies

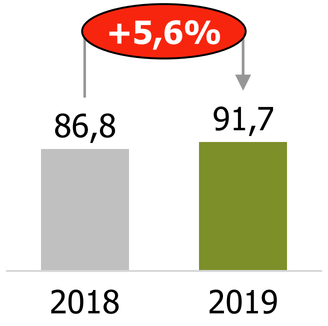
Rail – export coal

Cycle time (hours)



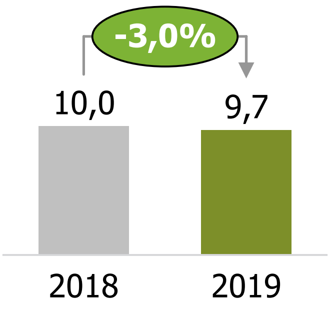
Rail – export iron ore

Cycle time (hours)



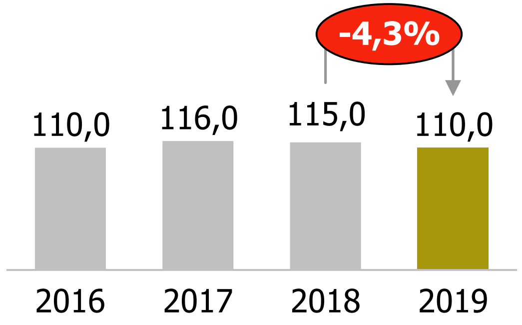
Rail – GFB

Wagon turnaround time (days)



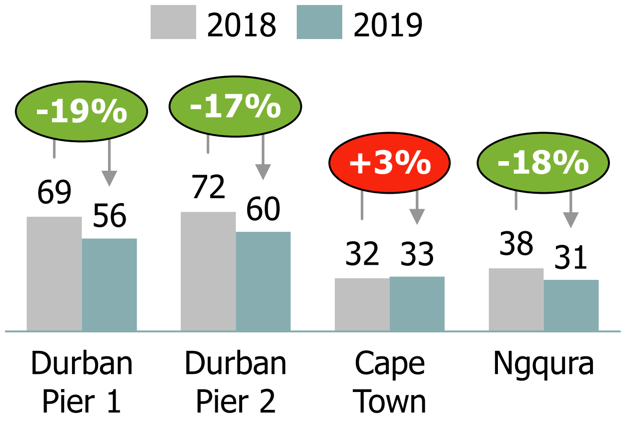
Pipelines

NMPP capacity utilisation (Mℓ/Week)



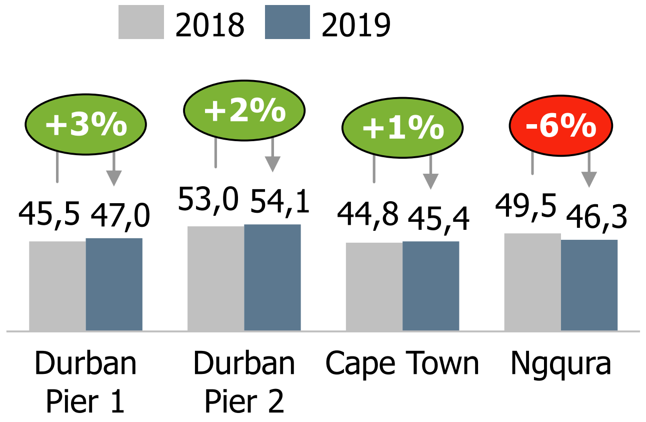
Port containers

Ship turnaround time (hours)



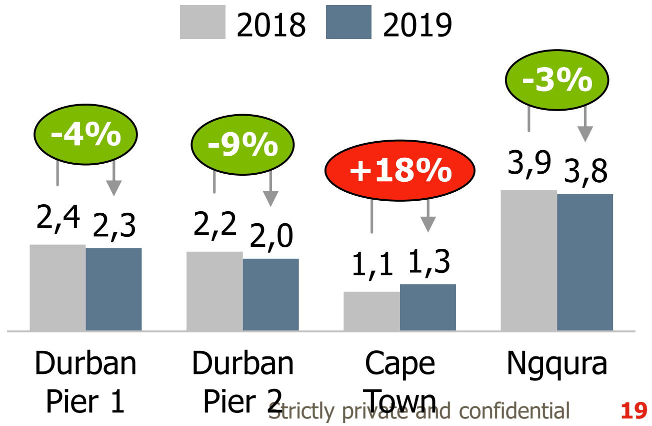
Maritime

Container moves per ship working hour



Maritime

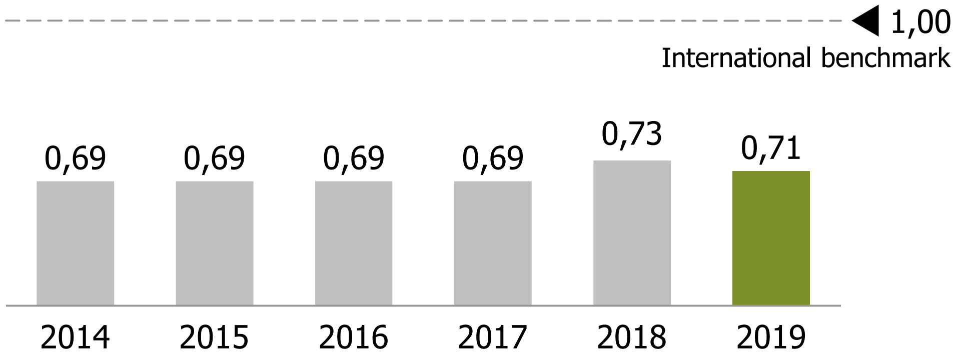
Train turnaround time (hours)



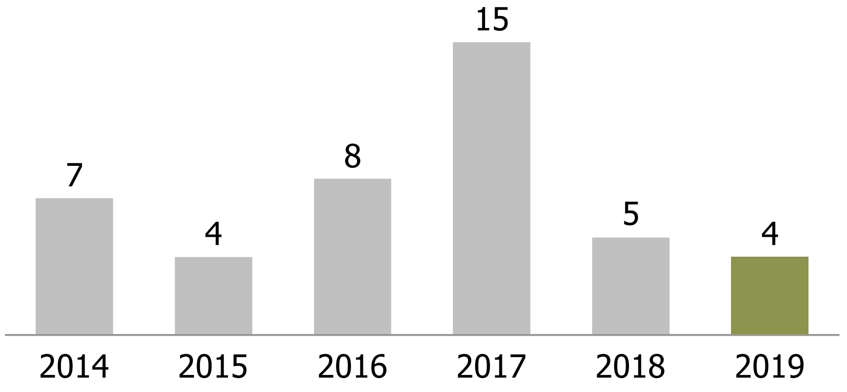
Safety and Human Resources

Safety and human resources

Disabling injury frequency rate (DIFR)



Employee fatalities (number)



55 946

Transnet employees*

A representative workforce.

Designated categories	Target % 2019	Actual % 2019
Black	89,0	88,2
Females at Exco	50,0	38,1
Females at extended Exco	50,0	44,4
Females below extended Exco	32,3	28,9
People with disabilities (PWD)	3,2	2,3

Skills development, capacity building and job creation

Key performance indicator	Unit of measure	Annual target	Actual 2019
Training spend	% of personnel costs Rand million	≥ 3,1	2,5 691
Engineering trainees	Number of learners	≥ 60	60
Technician trainees	Number of learners	≥ 200	200
Artisan trainees	Number of learners	≥ 200	223
Sector specific trainees	Number of learners	≥ 1 002	1 635

**Including contract employees (permanent headcount of 50 798).*

Socio-economic developmental outcomes

Community development

Phelophepa healthcare trains I&II

- 91 548 patients assisted on-board.
- 315 319 individuals assisted through outreach services.
- 4 400 girls assisted by providing healthcare education, as well as menstrual health and hygiene resource materials.
- More than 600 medical trainees received experiential training on board the two train clinics.

Employee volunteer programme (EVP)

- The employee volunteerism portfolio contributes towards building sustainable communities.
- 60 employees volunteered at the Horizon View School blitz to develop a sport facility for the school.

Socio-economic infrastructure development (SEID)

- A total of 12 sites have been identified on the coal channel for new CSI centres.
- The Idondotha centre is one of the 12 sites, and construction is 90% complete.
- 32 522 clients have received social and safety services at Ireagh, Khuma, Springs, and Thokoza centres.

Ideal clinic

- Established 'Adolescent Youth Friendly Health Facilities' in Ermelo, Lichtenberg and Bloemfontein.
- Provides capacity at local clinics to service adolescent and youth clinical, psycho-social and education health needs.

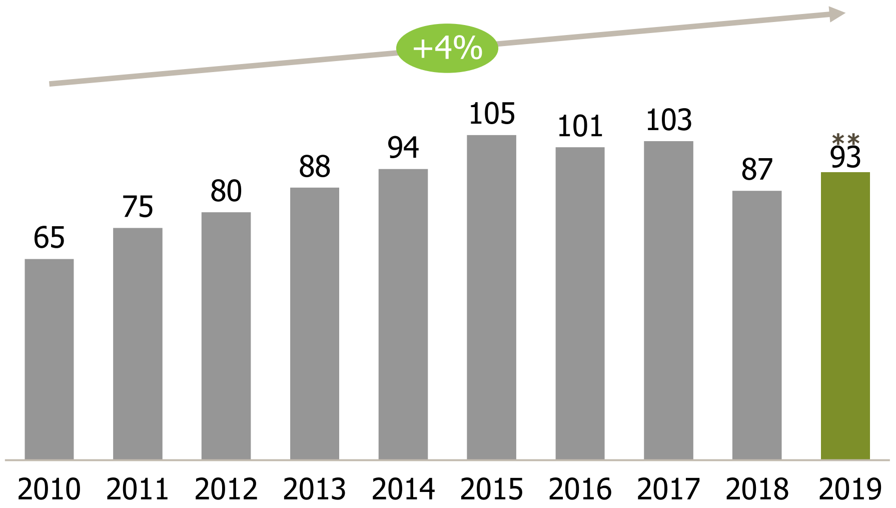
Teenage health

- Successfully implemented in all nine provinces.
- Annual target of 10 000 has been exceeded by 46%.
- Provided with Transnet school bags and a range of toiletries and a health education journal to promote good health and hygiene practices.

Industrial capability building and transformation

Broad-based black economic empowerment (B-BBEE) and local supplier industry development

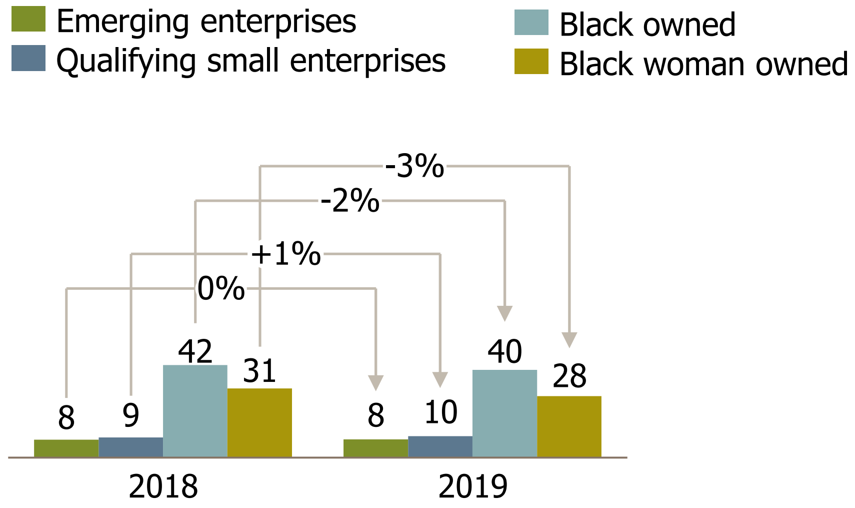
% B-BBEE spend of TMPS*



* TMPS – Total measurable procurement spend.

** B-BBEE spend down from 2017, due to suppliers being impacted by the introduction of the new codes, the reduction in TMPS and the increase in level 9 suppliers that do not qualify.

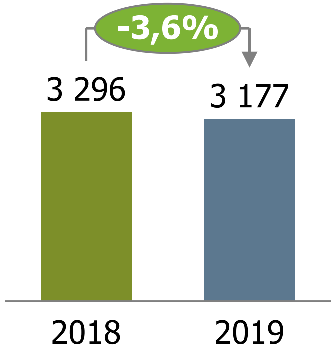
B-BBEE categories spend % of TMPS*



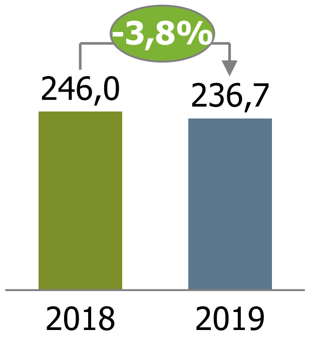
Energy efficiency, carbon emissions reduction

ENERGY CONSUMPTION & EFFICIENCY

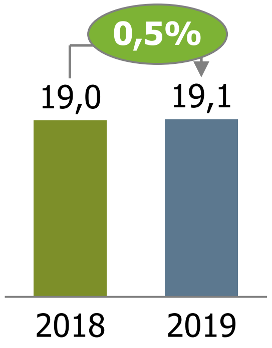
Total electricity consumption (GWh)



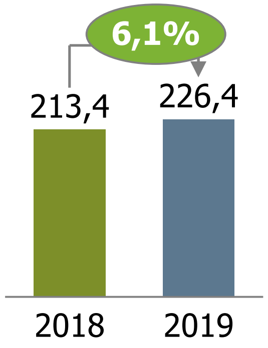
Total fuel consumption (million litres)



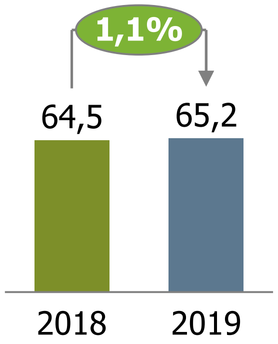
Total energy efficiency (ton/GJ)



Traction fuel efficiency (gtk/litre)

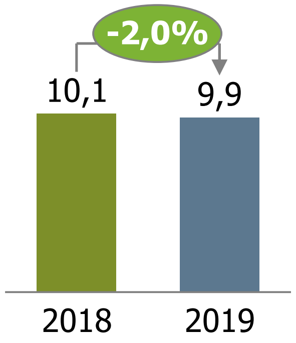


Traction electricity efficiency (gtk/kWh)

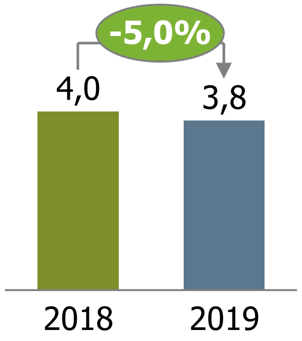


CARBON EMISSIONS

Carbon emissions intensity ($kgCO_2e$/ ton)



Carbon emissions ($mtCO_2e$)



Freight commodities market share gains from road hauliers resulted in **carbon emissions savings** to the South African transport sector of 110 0795 **$tC0_2e$.**

304 853MWh electricity regenerated by the new 15E, 19E, 20E, 21E and 22E locomotives.

$tC0_2e$ - tons of carbon dioxide equivalent.
GWh - Gigawatt hours.
GJ – Gigajoule.
Gtk - gross ton km.

Irregular Expenditure

The following table is a summary of the reported irregular expenditure as set out in note 40.1 to the Transnet 2018/19 financial statements.

Category of reportable items		March 2019 R 'million	March 2018 R 'million
Current year spend in respect of contracts entered into in the current year	"A"	1 618	3 427
Current and prior year spend, identified in the current year, in respect of contracts entered into in prior years	"B"	4 846	4 696
Non compliance to PPPFA – Tender pre-qualification criterion	"C"	1 929	0
Spend in respect of the 1064, 95 and 100 Locomotive transactions and associated transaction advisory services	"D"	41 529	0
Total irregular expenditure		**49 922**	**8 123**

"A" represents the extent of non-compliance in the current year. The relatively small number for this category is evidence of the success achieved to limit new incidents of non-compliance.

"B" represents expenditure from contracts entered into in prior years and includes expenditure that should have been reported in the prior year i.e. the R8.1 billion reported in the prior year was assessed to be incomplete.

"C" is expenditure relating to the newly identified (and contested) SD tender prequalification criteria and, the uncertainty around the accuracy of this number is the reason for the audit qualification.

"D" is expenditure, from contract inception to date, on the locomotive contracts entered into prior to 2015, which were the subject of several investigations at the time of finalising the prior year annual financial statements. The reason for these contracts being declared irregular is primarily due to the fact that the tender evaluation committee relaxed the local content requirements that were specified in the tender.

76 disciplinary cases have been finalised against employees for non-compliance with the PFMA; cases that are still pending finalisation will be reported in 2020

429 criminal cases have been lodged with SAPS in relation to losses through criminal conduct.

Conclusion

Transnet is confident that the continued efforts of the current leadership to enhance internal controls, improve operational efficiency and customer service, and to shape the ethical cultural bedrock, required to set the Company on its new growth trajectory, will deliver the quality and reliable service needed to build a globally-competitive national freight system.

The Company is expected to continue to generate strong cash flows, to maintain affordable levels of debt without any Government support, and to continue to report year-on-year improvement in financial performance.

More importantly, Transnet will continue to strive to contribute to the overall efficiency and growth of the South African logistics environment and, in turn, have a positive impact on the economic growth of the country.

TRANSNET

Thank you