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An analysis of Transnet's annual report for the 2010/11 financial year

1. Introduction.

Transnet is one of the nine State-owned companies under the auspices of the Department of Public Enterprise. The entity is obliged by legislation to present its annual report to Parliament for scrutiny, and for parliament to assess whether the company has complied with all government regulatory policies (i.e Treasury and PFMA) and objectives. This exercise forms part of parliament's oversight responsibility over the Department of Public Enterprises and state-owned companies.

The official announcement by Transnet on 27 June 2011 stated that Transnet SOC Ltd announced a positive set of financial results for the year to 31 March 2011, despite a challenging operating environment characterised by three-week long industrial action, significant derailments and rising input costs. The company's revenue increased 6.6% to R38.0 billion during the year under review, compared to the 2009/10 financial year. Significant increases in input costs did not dampen cost reduction initiatives implemented throughout the year, with the company recording cost savings of R2.1 billion. Earnings before interest, taxation, depreciation and amortisation (EBITDA) - Transnet's key measure of profitability - increased by 9.4% to R15.8 billion, resulting in an EBITDA margin of 41.5%.[1]

2.1 Transnet mandate

The mandate of Transnet is to assist in lowering the cost of doing business in South Africa, enabling economic growth and ensuring security of supply through providing appropriate port, rail and pipeline infrastructure in a cost-effective and efficient manner, within acceptable benchmarks.

2.2 Transnet's vision

Transnet is a focused freight transport company, delivering integrated, efficient, safe, reliable and cost-effective services to promote economic growth in South Africa.

2.3 Mission

Transnet mission is to be a reliable, trustworthy, responsive and safe company with a committed workforce, that is safety conscious, ethical, disciplined and result oriented.

[1] Railways Africa (2011).

3. Government's Strategy.

Government's overarching policy framework is the national New Growth Path and the Industrial Policy Action Plan II, which both assists departments in identifying government's key focus areas for the country's economic development and industrialisation process. The New Growth Path emphasises investment on infrastructure as key to the country's economic growth and job creation. President Jacob Zuma committed his administration to addressing the problem of unemployment through practical measures,"[2] and he concluded his statement by saying, "[...] therefore, 2011 will be the year of job creation through meaningful economic transformation."[3]

Apart from job creation government expect State owned companies to lead the way in skills development and leveraging their procurement policies for localisation in order to ensure a sustainable and a growing industry-based economy. The New Growth Path policy framework identifies the infrastructure programme as one of the "job drivers" of the country's policy instruments against unemployment.[4] Government expects about 250 000 jobs per year to emanate from the infrastructure programme undertaken by all SOCs and the relevant departments. In overall the generic strategic objectives of State-owned companies can be summarised as contributing to economic growth through:[5]

- The provision of world class infrastructure and technologies
- The expansion of economic infrastructure
- Job creation and skills development; and
- Industrial capacity building through a more strategic approach to procurement and operations

All of this points to the importance of State owned companies' performance in contributing to the country's growth objectives. State owned companies will also form part of the Monitoring and Evaluation Unit work, as the president once put it that this office, "[...] will also involve State-owned enterprises [...] in the government planning processes and improve the monitoring and evaluation of their performance."[6] To realise these objectives the President went on to say, "[...] we will hold Cabinet Ministers accountable through performance instruments, using established targets and output measures [...]."[7]

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[2] Zuma, J (2011a)

[3] Ibid

[4] Economic Development (2010) New Growth Path

[5] Transnet (2011)

[6] Zuma, J. (2009a).

[7] Zuma, J. (2009b).

4. Transnet's strategy

In 2009 Transnet adopted the Quantum Leap strategy aimed at rapidly improving the pace of volumes and revenue as well as significantly making safety, productivity and efficiency improvements.[8] During the year under review the Group is of the belief that the Quantum Leap strategy has delivered to most of its divisions and cost-reduction initiatives contributing to profitability of the company. The Quantum Leap strategy has also incorporated within its plans and processes elements of the New Growth Path's strategic objectives as well as government's Statement of Strategic Intent.

Transnet has five divisions namely, Freight Rail, Rail Engineering, National Ports Authority, Port Terminals and Pipelines. As a State-owned company Transnet has formalised a high level commitment to the objectives of the New Growth Path, covering key focus areas such as skills development, job creation, the green economy, localisation through competitive supplier development and rural development.[9] The ability of the company to contribute value to society is directly aligned with the operational goals as contained in the company's Quantum Leap strategy whilst also incorporating within its plans and processes elements of government's Statement of Strategic Intent. The strategy has identified eight key focus areas, namely:

- Productivity and efficiency
- Volume growth
- Capital investment
- Financial sustainability
- Human capital
- Strategic enablers
- Safety, health, environment and quality
- Regulatory

The Quantum Leap strategy is driven by integrating commercial services across the operating divisions to offer a seamless service. This includes increasing the Groups' market share whilst also ensuring new capital investments are translated into tangible benefits by improving the level of productivity and reliability. The Group is also determined in maintaining the investment grade credit rating, talent management including critical skills development. This also includes fostering mutually beneficial relationships with various interested and affected stakeholders including amongst others, regulators and communities.

5. Transnet's performance for the 2010/11

Transnet signed a performance agreement with the shareholder regarding the entity's targets for the 2010/11 financial year. The company's performance targets per division are contained in the Shareholder's Compacts and are also reflected in the Group's annual report for 2010/11 as

[8] Transnet (2011)

[9] Ibid.

performance indicators. Transnet has not met some of its targets due to the three week long industrial strike action that took place May 2010.

5.1 Freight Rail

On operational efficiency, Transnet's General Freight Business could not achieve its targets especially on coal and iron ore exports. On safety, the division on both employee fatalities and public fatalities did not achieve its target of zero tolerance as 8 employees and 138 public fatalities were recorded.

5.2 Rail Engineering

The division has met most of its targets on operational efficiency, infrastructure and human capital. The division has however failed to meet its targets on Broad Based Black Economic Empowerment (managed to reach 44 instead of the targeted 80 on BBBEE procurement) as well as on employment equity as it managed to reach 74, 4 out of a target of 78.0. On safety the division recorded 128 safety incidents out of a target of 114 with one employee fatality.

5.3 National Ports Authority

The division's overall performance showed improvement compared to the previous financial year, and almost all the targets were met except for the expenditure on capital investment of about R2 billion which was less than the R3,4 billion target agreed upon with the shareholder. There were no employee or public fatalities and only 32 recorded disabling injuries; an achievement as they were expected to be no more than 40 in terms of targets.

5.4 Ports Terminals

Performance by the National Ports Authority increased due to the division meeting most of its targets. Similar to the National Ports Authority division the Port Terminals' division on capital investment (infrastructure) spent R866 million and less than the targeted R1,3 billion. On Safety there were 1436 reported incidents of safety and one employee fatality. Safety seems to be a challenge almost for all the Transnet divisions.

5.5 Pipelines

The pipeline division met all of its targets except slight production interruption which might have a negative impact on the division's overall performance. There were no reported employee and public fatalities. There was however 76 reported safety incidents and in terms of the target this was an achievement as safety incidents were not expected to be more than 86. On Electricity consumption the Group failed to meet its target of 218719 Giga-Watts but instead recorded 236117 GWatts of electricity consumption.

5.6 Questions

5.6(a) Safety seems to be the challenge in almost all Transnet's divisions and as the Chairman of the Board indicated in his report that the Group lost 12 employees while on duty, the question is what is the Group doing to achieve a zero tolerance rate on fatalities and safety incidents?

5.6(b) The Pipelines division has underperformed in the 2010/11 financial year - will that be a justifiable criterion to disqualify the staff in the division from getting their bonuses? How does Transnet deal with bonuses if one of their divisions under performs?

5.6(c) An increase in cable theft from 41% to 51% amounting to R38 million in total seem to imply that anti-cable theft security measures are not working. What is Transnet doing to improve the situation and to bring down cable theft?

6. Financial performance

Table 6.1

A summary of Transnet's financial performance

REVENUE	2010/11	2009/10	2008/09
Revenue	R37, 9-billion	R35, 6-billion	R33, 5-billion
Profit for the year (Loss)	R4, 1-billion	R3 billion	R4, 5-billion
BALANCE SHEET	**2010/11**	**2009/10**	**2008/09**
Equity and liabilities	R167 billion	R138, 8-billion	R118-billion
CASH FLOW	**2010/11**	**2009/10**	**2008/09**
Operating activities	R13, 1-billion	R12 billion	R20, 4-billion
Investing activities	(R23 billion)	(R20 billion)	(R19 -billion)
Financing activities	R12,7-billion	R10, 3-billion	R11, 5-billion

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Transnet's revenue for the year ended 31 March 2011 has increased from R35, 6 billion to R37,9 billion for the financial year under review. The increase in revenue is attributed to an increase in volumes during the year, and an effective yield and mix management programme despite a protracted industrial strike action during May 2010. Of the four divisions performance improved compared to the previous financial year except for the Pipeline division whose revenue decreased by 3, 6% to R1, 13 from R1.17 billion.[10] The rest of Transnet divisions did well, with Freight Rail's revenue going up by 8, 6% to R22, 6 billion. Rail Engineering's share of revenue also went up to R8, 7 billion. Both the National Ports Authority and Port Terminals' revenue went up by 8, 0% and 23, 2% respectively. National Ports Authority's revenue was R8, 1 billion compared to R7,4 billion the previous financial year. Port Terminals also increased from R5,1 billion in 2010 to R6,3 billion in the financial year under review.

For the financial year under review the Group has made a profit of R4, 1 billion, and in the same year government has guaranteed certain borrowings for Transnet to the amount of R9,

[10] Transnet (2011)

5 billion. For the 2010/11 financial year the Group's borrowings amounted to R60,0 billion, and has spent in total R21, 5 billion for the year under review. And again the Group's expenditure projections for the 2011/12 financial year are estimated at R12, 9 billion, and over the five-year period the Group will spend about R110, 6 billion for its infrastructure build programme. Transnet's overall debt in total at the end of the 2010/11 financial year is R93, 4 billion, and the entity's gearing ratio is safely perched at 41.1%

Transnet's projected expenditure of the R110, 6 billion for the next five years per division is as follows

- Freight Rail R63, 7 billion
- Rail Engineering R1, 6 billion
- National Ports Authority R23, 2 billion
- Port Terminals R5, 0 billion
- Pipelines R15, 1 billion
- Special Units R2, 0 billion

The investment plans are aligned to the strategic objectives of the Company and support the New Growth Path. As a State owned company Transnet will continue to play its role to provide responsive infrastructure that creates appropriate capacity ahead of demand in the context of affordability, a fair return on invested capital and supporting economic growth by partnering with the private sector.[11]

Capital investment (excluding capitalised borrowing costs) rose to R21.5 billion from R18.4 billion previously, a 16.6% increase. R11.4 billion of this was invested on expanding the current infrastructure and equipment, while R10.1 billion was allocated towards the maintenance of existing capacity. [12]

Transnet's rolling five-year plan has been revised up to R110.6 billion from the previous five years' R93.4 billion. This is to meet the required volumes and to support the growth initiatives embarked on, especially in the later years of the programme. [13]

Approximately 58.3% of the R110.6 billion capital investment plan will be spent on rail which suffered from decades of underinvestment in the past and will address the negative impact of ageing rolling stock and infrastructure on productivity. Transnet's comprehensive fleet renewal plan will improve Freight Rail's active wagon and locomotive fleet by 6% and 18% respectively as the company creates additional capacity on the coal line to 81.0mt by 2016, 110.7mt in general freight by 2016 and 60.7mt in export iron ore by 2014. This will be done

[11] Ibid.

[12] Railways Africa (2011).

[13] Railways Africa (2011).

through a combination of productivity improvements, efficiency gains and capital investment.[14]

In addition to the projects identified and to be funded through the comprehensive funding plan, Transnet has identified several private sector partnership opportunities as part of their medium to long-term infrastructure development plan. They are finalising the costs of these developments but it is clear that they cannot fund them on their own. [15]

6.1 Questions

6.1(a) At what stage is the investigation by the panel of experts on Transnet's New Multi-Product Pipeline's cost-overruns?

6.1(b) Transnet is of the view that the potential for regulators to impact the Company adversely in determining and setting tariffs that may negatively affect the future sustainability of the Company remains a key risk for the Group.[16] **Has anything been done by the regulators (e. g NERSA - which Transnet's divisions fall under) to improve their methodology in handling tariff-increase applications which may also improve Transnet's capital expenditure requirements?**

7. Auditors' opinion

Transnet's financial statements for the 2010/11 financial year were audited by *Deloitte & Touche*. The auditing firm gave Transnet a clean audit (unqualified audit opinion) pointing out that in their opinion, "[...] the consolidated and separate financial statements *of Transnet* present fairly, in all material respects, the consolidated and separate financial position of Transnet SOC Ltd as at 31 March 2011."

The auditing firm however draws attention to the following three aspects (procurement, contract and expenditure) in contravention of the laws and regulations (Public Finance Management Act 1 of 1999) of state companies and institutions, and they are:

1. Fruitless and wasteful expenditure of R36 million on the procurement of a Pneumatic Ship unloader.

2. Irregular expenditure of R8, 3 billion relating to;

   (a) Contracts for the provision of Engineering, Procurement and Contract Management (EPCM) services on capital projects

   (b) Contracts for the supply of 32 Rubber Tyred Gantry (RTG) cranes

   (c) Contract for the accommodation of staff; and

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[14] Railways Africa (2011).

[15] Railways Africa (2011).

[16] Ibid.

(d) Contract for the supply of rails

These matters as identified by auditors have since been remedied. In other words internal controls have since been significantly strengthened to avoid future occurrence of the same incidents.

8. Transnet's Human Resource.

Transnet has a total workforce of 49 078 employees comprised of 47 763 permanent employees and 1315 fixed term contract employees.[17] In terms of Employment Equity, African employees represent 62% of Transnet's workforce, while Indian and Coloured represent 4% and 10% respectively. Whites in the company represent 24% of Transnet's workforce. In terms of gender male representation at Transnet stands at 80% and female at 20%. The Group recognises the under representation of females and its poor performance on people with disabilities (0, 8% representation) as a challenge and has been taken up as part of the entity's Employment Equity Plan.

The availability of appropriate skills across Transnet remains a significant challenge and the entity plans to spend approximately 3% of total personnel costs on training initiatives annually.[18] In line with the new Growth Path's objectives, the Company is planning to expand its capacity through the creation of an integrated value chain from secondary educational institutions through to tertiary educational institutions and Transnet's School of Excellence Training centres.[19] This will allow the Company to maintain a skills and talent pipeline that continuously supports the needs of the company, whilst also providing skills training for the larger South African market.

To complement its secondary and tertiary training initiatives the Company continues with its leadership programmes namely, the Navigator Leadership Programme and the Executive Leadership Programme. The former focuses on building capacity for Transnet's managers while the latter focuses on building capacity at executive level. In supporting the national skills agenda Transnet training initiatives are aligned with relevant platforms in training processes such as the Transport Education training Authority, the Department of Public Enterprises and the Department of Trade and Industry.

8.1 Question

8.1(a) A few years ago Transnet was part of the Joint Priority Skills Acquisition (JIPSA) initiative to address specifically the shortage of critical skills within SOCs and the country in general. How has Transnet benefited from this initiative if skills shortage is still a challenge – is Transnet still part of JIPSA?

[17] Transnet (2011)

[18] Ibid.

[19] Ibid

8.1(b) The under representation of women and people with disabilities seems to be a common challenge amongst State owned companies for a number of years now. In previous interactions the committee had asked SOCs to expand their recruitment strategies to reach graduates in rural areas. Has this been the case and what is Transnet's experience in recruiting women graduates in rural areas?

9. Conclusion.

Transnet has been consistent in its performance for the past financial years despite the many challenges the company had to deal with both economically and operationally. The performance of the company to date is an admirable one and is a reflection of management's commitment to expand Transnet's market share. Much more so because Transnet infrastructure programme is funded off the Group's balance sheet, with little or no funding from government. There is however a belief that Transnet, in fact all of the State owned companies can do more than they are doing in meeting government's development objectives.

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10. References.

1. The New Growth Path (2010) The Department of Economic Development

2. Transnet, Annual Report (2011) "Quantum Leap."

3. Transnet, Annual Report (2008): "From turnaround to growth".

4. Transnet, Annual Report (2009): "Positioned for growth."

5. Zuma, J. (2009a) ANC January 8th Statement.

6. Zuma, J. (2009b) State of the Nation Address, Parliament of the republic of South Africa

7. Department of Finance, Public Finance Management Act 1 of 1999

8. Railways Africa (2011). *Transnet results.* [Internet] Available at: http://www.railwaysafrica.com/blog/2011/07/transnet-results-8/ [Accessed on 21 July 2011].