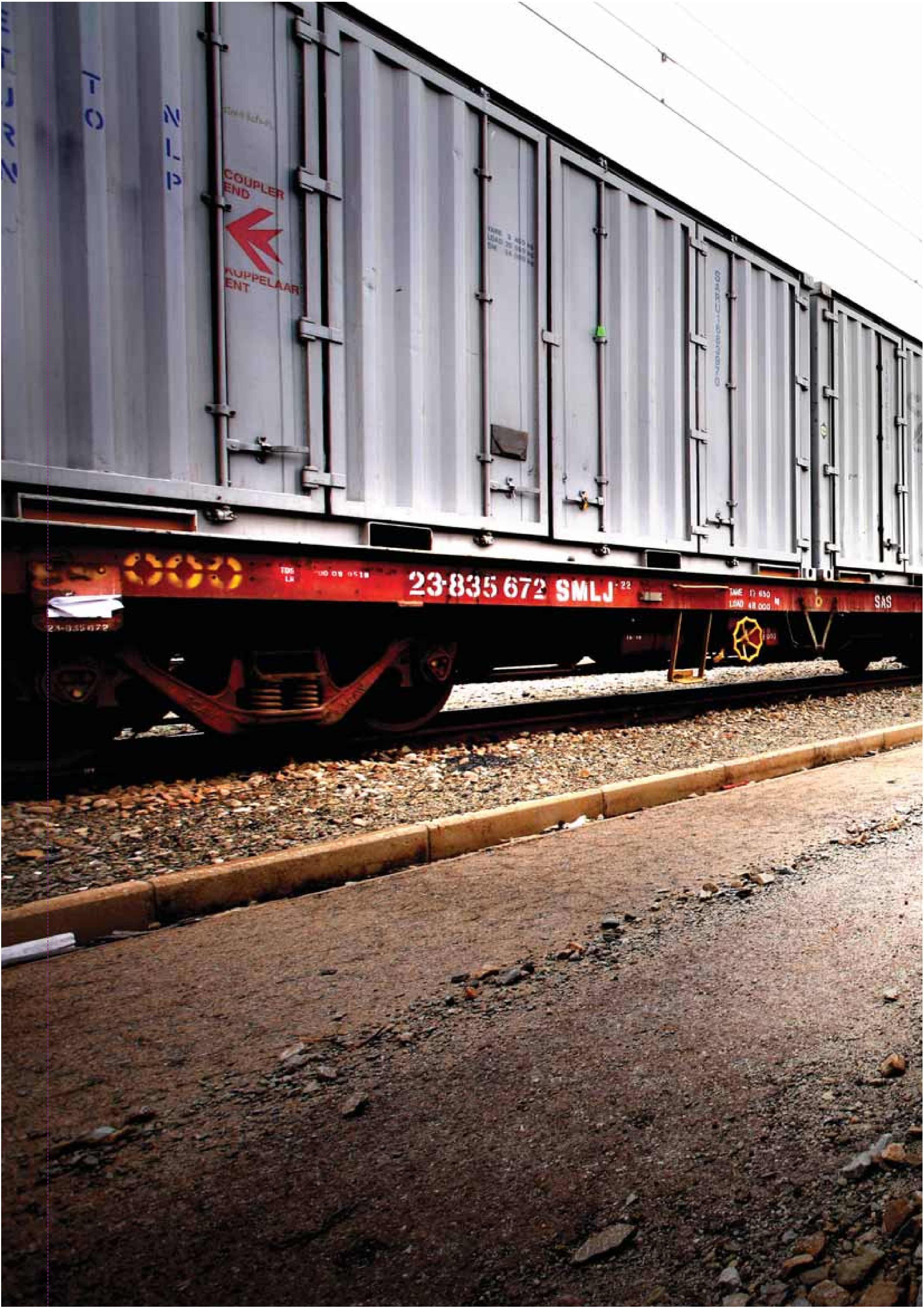

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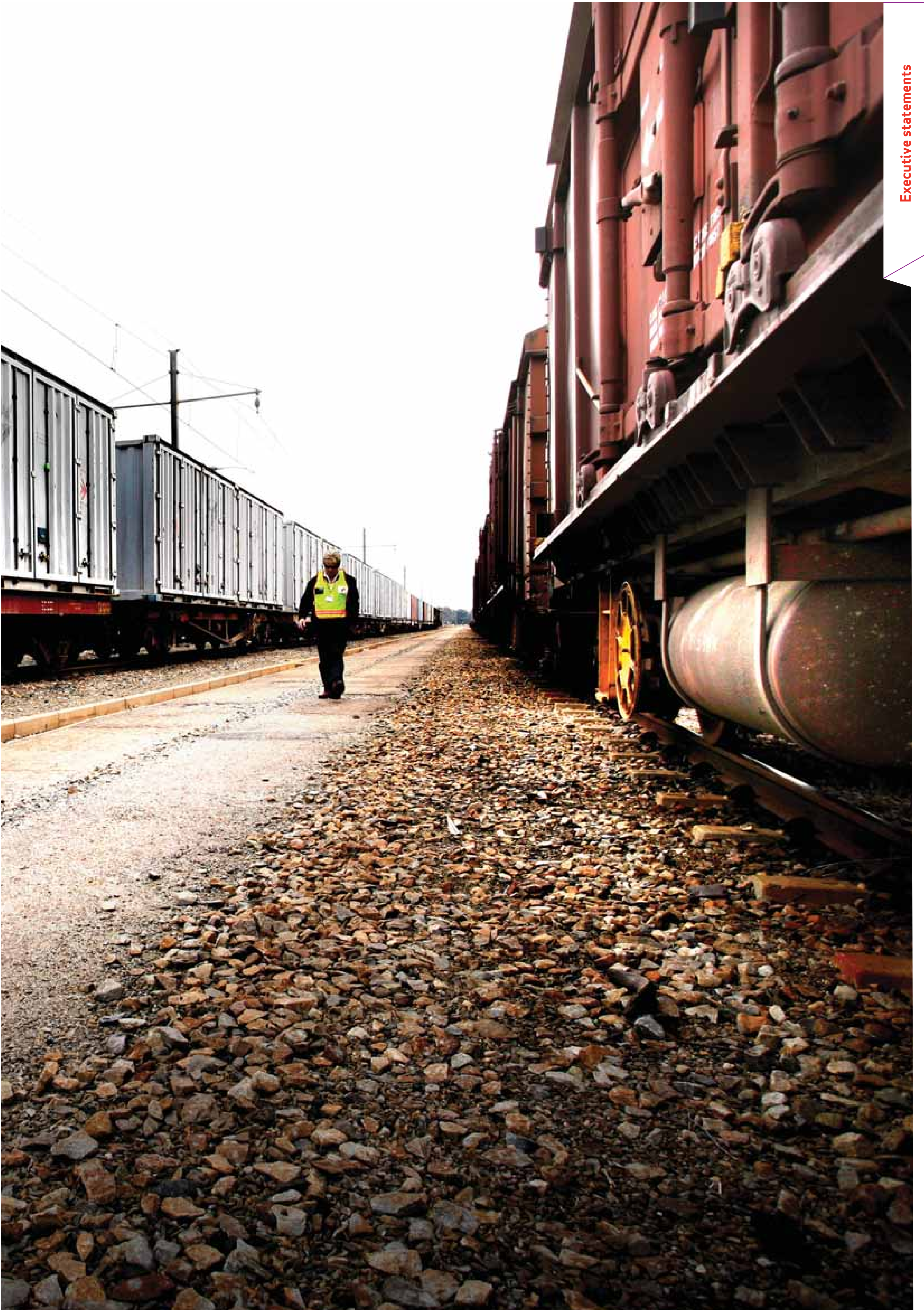


Chairman's review

FTM Phaswana
Chairman

Introduction

The review period marked the first full year of implementing our Growth Strategy, which had evolved from the completion of the turnaround strategy implemented in the first five years of the current leadership of Transnet. Therefore, I intend using this space to report on the progress made in implementing this plan, the challenges encountered during the review period, and outline our medium-term outlook for the business to enable all our various stakeholders – notably financiers, investors and the Shareholder – to make informed decisions about the state of the business.

In brief, this report, which communicates the essence of the Company, will show that the project of remaking Transnet is complete; that the Company's resilience has helped it to navigate one of the most severe downturns in history; that it is delivering on its commitment to all its various stakeholders; its financial and operational foundations are strong; its prospects are brighter as evidenced by the increasing number of investors who are injecting money into the Company; and it is poised to take advantage of the growth in the future.

The economy

The past financial year has been a defining year for Transnet, one which has demonstrated very clearly the robustness of Transnet's turnaround initiatives. The vast improvements in both the financial health of the Company and the efficiency and productivity of operations have seen Transnet weather some of the most challenging economic storms in recent history while still delivering growth, strong financial results and continuing to invest record amounts on capital investment.

The ongoing implementation of the Growth Strategy has transformed Transnet in significant ways. The benefits of greater integration have been felt in every area of the business, particularly in commercial offerings and operations. The restructuring of customer processes has ensured that Transnet is far more sensitive to the needs of our customers and is able to respond rapidly to these changing needs. This new capability has stood us in good stead over the past year and is especially relevant in these trying times.

Economic review

After experiencing an exceptionally good run of growth of around 5% from 2004 to 2007, the latter half of 2008 proved to be significantly more challenging for the South African economy. Even before the financial crisis intensified in September 2008, the economy was in the midst of a cyclical slowdown characterised by a sharp reduction in consumer demand. Although a slowdown was anticipated, very few analysts, save for "Dr Doom", a.k.a. Dr Nouriel Roubini, had anticipated the devastating impact that the subprime crisis would unleash on the global economy.

Global output and trade plummeted in the final months of 2008 and remain at low levels. The continuation of the financial crisis has caused asset values to fall sharply across advanced and emerging economies, decreasing household wealth and thereby putting downward pressure on consumer demand. In addition, the associated high level of uncertainty has prompted households and businesses to postpone expenditures, reducing demand for consumer and capital goods. At the same time, widespread disruptions in credit are constraining household spending and curtailing production and trade. World gross domestic product (GDP) growth is estimated to have slowed to 2,5% in 2008 from 3,7% in 2007. Growth in world trade volumes, which has fuelled global growth in recent years, is also estimated to have slowed to 6,2% from 7,5% a year earlier.

Although the South African financial system remains sound, thanks to prudent regulation by policy-makers, the economy is reacting in much the same way as in many other countries. The GDP growth figures for the first quarter of 2009 confirmed that South Africa is officially in recession. The scale of the contraction was very surprising, however with the 6,4% decline in output reflecting the worst quarterly performance since the third quarter of 1984. Sharp contractions in mining (33%) and manufacturing (22%) production are partly reflected in the decline in freight volumes handled by Transnet. GDP growth slowed to 3% in 2008 from 5,1% in 2007 with year-on-year exports and imports declining by 2,5% and 4,2% respectively.

From Transnet's perspective, the past year was characterised by two very different halves. Even in the face of slowing global activity, commodity prices and freight volumes continued to grow during the first half of the year before abruptly declining as the global financial crisis intensified in September 2008 and spilled over into the real economy. Many of Transnet's customers have had to confront sharp reductions in both prices and demand for their goods.

Economic outlook

Looking ahead, it is very concerning that the full effect of the global economic crisis has not yet been determined and several possible outcomes for the global economy remain plausible at this juncture. There is a strong possibility that global GDP will contract for the first time since the Second World War, with the simultaneous recession amongst the world's largest economies projected to extend into 2010. One of the biggest implications of the weak growth environment is that global trade volumes are set for the biggest decline in 80 years.

Rising protectionism is a critical concern. Unfortunately, this monster is rearing its ugly head in the world's leading economies despite vocal denouncements by world leaders. This is especially concerning given the proven benefits of open and free trade markets. The World Trade Organisation, the trade watchdog, forecasts a 9% decline in global trade volumes in 2009. This will be the first fall in international trade volumes since 1982 and a significant deviation from the established trend which has seen trade volumes grow by more than 6% per year between 1990 and 2006, far outstripping the growth rate of world output, which averaged around 3% over the same period.

The fundamental supply constraints underlying the recent commodity boom remain in place and the rapid supply reduction currently taking place, especially with respect to steel and steel-related commodities, raises the risk that commodity prices could once again increase sharply as demand recovers.

The outlook for the South African economy is similarly uncertain. The dominance of commodities in South Africa's export basket means that domestic exports are being hit both by a price and volume effect. The potential export weakness is not limited to mineral products. Vehicle export volumes which have boomed in recent years are forecast to decline by more than 30% during 2009. Real exports are projected to decline by more than 8% in 2009, with a mild recovery expected in 2010. Weakness in the export market for mining and manufacturing is expected to weigh on consumer demand while private sector investment is also forecast to decline during 2009. There is therefore a real risk of contraction in 2009. The last time that this occurred was in 1992.

Assuming a speedy resolution of the ongoing crisis in the financial system, the outlook for commodities over the next 24 months depends largely on the performance of emerging markets, particularly China. The Chinese economy is more open to trade than ever and thus very exposed to the global slowdown. The United States, European Union, and Japan represented 47,4% of China's export market in 2007. The Chinese government has acted swiftly and decisively in rolling out stimulus policies and whilst risks are tilted to the downside, the Chinese economy is likely to maintain a growth rate above 7% for 2009. This will provide a much needed stimulus for commodity demand, particularly metals and energy-related commodities.

The sharp reduction in dry bulk ocean freight rates will provide a significant boost to the competitiveness of South African commodity exporters. The Baltic Dry Index (BDI) – which is not only a measure of global supply and demand for the commodities, but also an indicator of global trade and of likely future economic performance – has fallen by about 89% from its peak towards the middle of 2008 and a quick recovery is not foreseen as a result of a significant amount of new capacity scheduled to come on stream over the next two years. Sustained lower ocean freight rates will allow South African commodity exporters to exploit their generally low cost positions to capture additional market share, particularly in emerging markets.

Drewry Research, which tracks supply and demand growth, forecasts global container trade to be up by 7,2% in 2008 and growth of just 2,8% in 2009. South African manufactured exports have significant exposure to the European and US markets accounting for 33% and 15% of total exports respectively. This has been reflected in the volumes of containers handled by the ports in the past year. Total container volumes are forecast to fall in the short term, but strong growth in transshipment volumes is expected as Transnet pushes ahead with its plans to establish South Africa as a global transshipment hub. This will provide significant benefits to local manufacturers wishing to compete in export markets. The new container terminal at the Port of Ngqura will be commissioned during the third quarter of 2009 and will focus primarily on transshipment traffic.

The changing patterns of global trade are reflected in the growing size and importance of the emerging market container trade routes. South-South trade is likely to assume much more significance over the medium term where South Africa is well positioned to act as a consolidation point for these trades. A Southern African container hub will bring much needed economies of scale into the regional container freight system and will greatly improve maritime connectivity between the region and the rest of the world. I will return to this opportunity later in this statement.

While there is no doubt that conditions will be extremely challenging over the short term, Transnet is in a far stronger position to weather the crisis. The gains realised over the past five years have transformed Transnet into a far more agile and competitive company with a healthy financial position. Given Transnet's low market share in certain domestic freight, significant growth opportunities exist. Clear plans are in place to capture these opportunities which will be supported by the ever-increasing predictability, reliability and efficiency of operations.

Strategy review

Transnet's performance in a difficult environment in 2008 demonstrates the steady improvements that have been, and continue to be, realised in the fundamentals of the business. Transnet continued with the implementation of the Growth Strategy during the 2009 year. Several innovations were introduced in order to grow volumes and improve productivity and efficiencies in key operational areas. Despite the successful implementation of the required changes, market conditions, particularly during the second half of the year, meant that not all volume growth targets were realised.

Important successes were however achieved in key growth markets. A focused effort on the container sector over the past year has seen container volumes on rail increase by 9% against an overall market growth rate of 6%, reversing the long running trend of declining market share in this segment. Intermodal solutions represent not only an important growth opportunity for Transnet, but are also critical for the long-term competitiveness of the South African economy. A continued focus on this segment will ensure ongoing growth for Transnet. New initiatives will include investment in rolling stock and inland container terminals, improved technology solutions and partnerships with private sector operators to ensure that Transnet is able to provide customers with integrated door-to-door transport solutions.

Whilst key growth initiatives will continue to receive priority, a number of new initiatives has been identified for the year ahead to respond to the current economic environment. Like most companies, Transnet has not escaped, unscathed, the storm which is still unfolding and must navigate through it. At the same time our commitment to address the infrastructure backlog and expand the capacity on our network remains as firm as ever and we remain committed to the capital expenditure programme which is designed to renew our infrastructure and prepare the Company to support future growth of our economy. Which, in part, explains why we are proceeding apace with the five-year R80,5 billion (2008: R80,3 billion) Capital Investment Plan.

Borrowing requirements will increase over the next three years and specific attention must therefore be paid to maintaining key financial ratios, specifically gearing and cash interest cover. For the duration of the crisis, Transnet will focus on the pursuit of low cost growth opportunities, private sector partnerships, further cost reductions and enhanced efficiency of the Capital Investment Plan. I take comfort in the fact that Transnet is a well managed business with good growth prospects.

Some of the achievements in the review period

On behalf of the Board, I would like to commend the executive management for their achievements amidst the challenging year. These include:

- Another credible set of financial results – a 3,0% increase in EBITDA to R13,2 billion for the year ended on 31 March 2009;
- Meeting the financial, capital efficiency and socioeconomic targets agreed with the Shareholder;
- Effective management of the Company's balance sheet to protect its financial strength and investment-grade status among our investors;
- Continued efficiency and asset and labour productivity improvements;
- Accelerating the efficient, responsible and effective rollout of the investment programme – a 22,8% improvement in spending to R19,4 billion when compared to prior year's achievements;
- Improved cross-divisional capacity planning and capital project implementation;
- The continued gains made in investing in our people – at R420 million, our training expenditure is in keeping with targets agreed with our Shareholder and ranks amongst the highest among our peers, even in the throes of this downturn;
- Continued investment in quality relationships with all our key stakeholders notably our clients, labour, investors, financiers and regulators;
- Effective implementation of Board-approved risk management strategies; the gains thereon; and the fresh focus in achieving a turnaround in our safety performance;
- A visionary response to the global economic downturn; and
- The completion of the disposal of the remaining portfolio of our non-core assets to cement the project to remake Transnet.

Port of Durban: Africa's busiest port.

Chairman's review (continued)

Financial results

It is pleasing to note that the years of investment in building the resilience of the Company are continuing to pay off. It is a great pleasure to have to note that, once more, the Company has achieved the financial targets agreed with the Minister of Public Enterprises, our Shareholder Ministry.

Briefly, all indicators are trending in the right direction, albeit at a pace slower than our aspirations – our profitability is up; revenue is growing; borrowing is within the acceptable benchmarks; the balance sheet is strong to sustain Transnet's self-funding model; and the Company's investment plan is progressing according to expectations.

We are heartened that for the year ended 31 March 2009, revenue increased 11,6% to R33,6 billion compared to the prior year; earnings before interest, taxation, depreciation and amortisation (EBITDA) increased by 3,0% to R13,2 billion for the year resulting in an EBITDA margin of 39,3% (2008: 42,6%) driven by a combination of productivity improvements and cost-saving initiatives. Operating expenses grew by 18,0% to R20,4 billion in 2009, which is mainly attributable to an increase of 21,9% in energy costs and a significant steel price increase which impacted maintenance costs.

The moderate rise in costs, excluding those mentioned, shows the success of management's focus on containing costs whilst continuously looking for opportunities for revenue optimising and productivity enhancement activities – the sort of balanced approach required during times of a slowdown as the ones we are witnessing now.

The 14,5% increase in shareholder's equity is commendable and is in keeping with our goal of delivering fair returns and unlocking value to all our stakeholders.

Capital Investment Plan

The continued success in the execution of our investment plan is laudable. This is especially so given the fluidity in the capacity expectations and plans of our clients. The fresh records being achieved by the executive in the rollout of the programme are a source of great pride, not only to the Company, but to the country. Few companies have the capacity and expertise to manage a programme as large as the one we are undertaking. Excluding borrowing costs of R764 million, spending on capital rose 22,8% to new levels of R19,4 billion, which is both in line with our plans as well as targets agreed with our Shareholder.

This is further testimony to the soundness of our strategy for a dedicated unit to roll out this ambitious programme.

Significantly, we note the shift in the pattern of the investment programme: the bulk of the investment – some 56,2% – was in expanding our operations while the balance – 43,8% – was on maintaining current operations. This shows that the Company is now investing in growth by creating new capacity before it is needed.

The investment programme lies at the centre of our efforts to position the Company for growth. Whilst not shying away from our growth aspirations, we will continue to invest responsibly by funding projects that are – and/or will be – needed by our customers and clients and financing these off the strength of our balance sheet or together with other partners. This is to ensure the country's economic operators are poised to take advantage of growth opportunities when these return in future and that the country's economic development needs are not frustrated.

Transnet believes that its self-funding operating model is an important contribution a state-owned enterprise can make to a developmental state like our country.

Human capital implementation

The fruits of the investment in rejuvenating our human capital are beginning to show, especially in the areas of talent, reward, training and performance management. It is satisfying to see these plans guiding the deployment of senior people, replacing arbitrary appointments of the past and reversing decades-long neglect of this important asset: our people. Also praiseworthy are the strides being made in embedding the new culture as enshrined in our culture charter programme. Whilst more work needs to be done in aligning our human resources, especially the skills sets required to sustain our strategy in the future to the needs of the Company, considerable progress has already been made.

As part of our commitment to a better South Africa, Transnet will continue to invest towards broadening the talent and human resources pool available to the rest of the country. Therefore, the partnerships we have forged in the area of human resources (see the Group Chief Executive's review on page 49) will continue to enjoy our support.

The Board wishes to commend all management for its foresight and vision in putting the interests of the Company first, especially the protection of its financial strength and job security, by voluntarily agreeing a zero-percentage increase in remuneration for the first half of the 2010 year.

Corporate governance and risk management

Transnet is not only blessed with a committed and diligent executive cadre but it has in the past year continued to benefit from the wise counsel and guidance of an experienced, diverse and supportive Board of Directors. We have kept changes in the Board to a minimum to enable continuity and embed the improved governance practices of the past five years. We believe the balance in skills and experience of various Board members is appropriate for today's Transnet.

At the 2008 Annual General Meeting, Mr Stavros Nicolaou, a non-executive member of this Board and Chairman of South African Express Airways (Pty) Ltd (SAX), our former subsidiary which has since been disposed of to the Department of Public Enterprises (DPE), stepped down to concentrate on SAX. We thank him for his contribution. Simultaneously, the Shareholder appointed two new non-executive Directors onto the Board: they are respected businessmen Mr Mthandazo Peter Moyo and Mr Michael Hankinson.

In February 2009, Ms Maria Ramos, the Group Chief Executive of the new Transnet, stepped down for a career in banking. We wish her well.

Regrettably, the process of finding a permanent Group Chief Executive to lead Transnet into the future took longer to finalise than we had anticipated. Accordingly, it is very important to contextualise the delay.

As part of its corporate governance responsibilities, the Board – through its Corporate Governance and Nominations Committee – ensures that best practice succession planning policies are implemented in respect of the Company's Executive Directors and members of the Group Executive Committee. The appointment of the Company's Group Chief Executive, however, is ultimately the prerogative of the Shareholder – in this instance, the Government of the Republic of South Africa.

When the former Group Chief Executive made known her intention to leave Transnet's employ last year, we proceeded to work towards a smooth succession.

To ensure that Transnet is led by the best candidate available, we widened the internal succession pool by including external candidates who were identified by an independent executive search agency in accordance with criteria set by the Board. At the commencement of the process, the then Minister of Public Enterprises, Ms Brigitte Mabandla, MP, was consulted in her capacity as the representative of Transnet's only Shareholder.

The rigorous selection process identified only one unanimous candidate for appointment on time before the departure of the former Group Chief Executive. The candidate, who had participated in the selection process, withdrew his candidature after his name was recommended to the Minister by the Board.

Before the Board could initiate a fresh process to identify a new candidate to be recommended to the Minister, the Minister requested an opportunity to engage with the selection process.

To oversee the transition, the Board appointed Mr Chris Wells, the Company's Chief Financial Officer, to take over as Acting Group Chief Executive. We are pleased with the way he and the executive team have managed the transition.

A new selection process is now under way.

Apart from executive succession planning, we are also working with the Shareholder to ensure succession planning for the non-executive and independent members of the Board of Directors. This will guarantee that Transnet continues to be led by the best available talent through the continued renewal of skills and expertise as well as ensuring compliance with all the applicable corporate governance laws, regulations and conventions.

I am deeply saddened that despite the Company's efforts to improve our safety performance we have still too many fatalities. Our heartfelt condolences to all the family members and friends of the 13 colleagues and 197 members of the public who lost their lives during the last financial year.

The year was disappointing in terms of safety performance: employee and public fatalities as well as the associated costs of safety incidents increased making 2009 the worst safety year in four years. This is a blot in an otherwise excellent track record since this Board and the executive team launched the project to remake Transnet. There can be no justification for this poor performance. It is unacceptable to the Board and flies in the face of the culture we are trying to build at Transnet.

Our commitment to make a meaningful contribution to the vulnerable and disadvantaged communities remains steadfast. We are most humbled by the recognition of the innovation we brought to primary health care through the Transnet Foundation's Phelophepa health care train, and on receiving the United Nations Public Service Award for the category "Improving Service Delivery". This was followed by the Mail & Guardian "Investing in the Future" recognition for the Transnet Foundation's rural and farm schools sport development programme.

The Board welcomes the interest that has been shown to safety by leaders of our recognised trade unions. We also endorse the labour-management partnership that has been established to tackle safety head-on. No cost and effort will be spared to ensure that all our operations are safe.

Sustainability is a cornerstone of risk management and is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments highlighted on page 76 of the Sustainability Report. Being in the transport and logistics sector, we have both a challenge and a window of opportunity to improve on sustainability management and influence the supply chain. We are steadily integrating all material sustainability concerns into our normal governance practices. The future focus remains on enhancing and improving our sustainability management platform in line with the draft King III Report's philosophy that governance, strategy and sustainability are inseparable.

The new political administration

In April 2009, our country held the fourth successful national and provincial elections since the end of apartheid. These came after a robust and fiercely contested and, at times acrimonious and intensely personal, campaign season. Whilst there was no change in the ruling party, the elections have led to far-reaching changes in the political administration, the structure and operation of the Government, the thinking and ideological persuasion, as well as the political leadership of Transnet's Shareholder Ministry – Ms Mabandla, who retired after the elections, was replaced by Ms Barbara Hogan, as Minister, and Mr Enoch Godongwana, became the Deputy Minister of Public Enterprises.

The success of a company like Transnet is a result of many variables. The key variable in this is the relationship between the Company, as represented by its Board, and the Shareholder through the line ministry. Our belief is that this should remain dynamic, interactive and be based on frankness and mutual respect. Transnet welcomes the changes and the new appointments; they all retain our utmost respect and unwavering support. As our only Shareholder, we also take this opportunity to pledge our full cooperation and support to the new ministers in ensuring that Transnet continues to succeed in playing its rightful role of enabling growth, promoting competitiveness of the economy and facilitating socioeconomic development in our country.

External challenges

Economic regulation

Ours is a progressive, open and an increasingly globalised economy. In an economy like ours, regulators – especially the economic ones – play an important role in balancing the openly contradictory interests of various roleplayers in the economy. Simplistically, they have to reconcile the interests of consumers and those of the regulated entities and also ensure that their decisions are supportive of Government policy and objectives. This task, however, is complicated by a range of factors: particularly the country's stage of economic development; levels of competition and the multi-pronged mandate of the regulated entity and the maturity of the regulatory, policy and legislative framework.

Still, none of these issues should diminish the significance or the basic tenets of economic regulation: key amongst these, being that regulation must be fair, clear, open, transparent, predictable and consistent to ensure that markets operate efficiently and effectively, and that market failures are addressed speedily.

Also inescapable is the reality that investors are entitled to a fair return on the capital they deploy; and that directors of an investing company are duty and honour bound to ensure adequate returns for shareholders on capital invested. In a progressive economy, this unenviable task falls squarely on the shoulders of economic regulators. Certainty and consistent application of regulation ensures that investors can better predict cash flows, and managers can plan optimal funding solutions for a variety of investments being consummated.

Having experienced the longest period of economic expansion, South Africa today is finding itself in a position where it has to make massive investments to expand the economic infrastructure it will need when growth resumes. The current downturn has provided a brief respite to a capacity demand crunch.

What is required is an urgent review to ensure alignment between policy, regulation and legislation to support this phase of unprecedented investment in infrastructure. Unfortunately, as will be seen below, this ideal has yet to be achieved in our country. In the meantime though, we are operating in an environment of regulatory uncertainty. This significantly raises the cost of compliance and makes planning difficult.

Our aspiration is to forge a collaborative relationship which is characterised by high degrees of trust, information exchange, fact-based analysis and joint problem-solving with regulators. On behalf of Transnet, I would like to pledge our full co-operation with all the regulators in all the areas of our operation.

Pipelines

Transnet submitted an application to National Energy Regulator of South Africa (NERSA) to increase its tariffs to fund the operation of the existing pipeline network and assist in the financing of the required investment to replace and expand parts of the existing network. Transnet has consistently communicated that tariff increases are required to fund such investment as it increases its petroleum pipeline network by more than three-fold. Regrettably, NERSA's final tariff determination for the 2010 year provides for an effective 10,4% decrease in tariffs. An effect of this decision is to defer some revenue and interest due to Transnet, to when the NMPP is commissioned, thereby postponing the inevitable tariff increases. Of concern is the lack of consistency and predictability of the rules relating to the setting of tariffs by NERSA. As an example, the methodology applied in the determination of the 2009 tariffs was in some respects suddenly deviated from in the determination of the 2010 tariff.

Ports

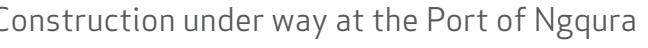
Since the commencement of the National Ports Act in 2006, Transnet has been in talks with the Government. These talks have centred around our concerns over what appears to be unintended consequences of the Act. Last June, Government gave Transnet the assurance that it had no intention of proceeding with the corporatisation of the National Ports Authority, as provided for in the Act, and would – to this effect – initiate a review process that would result in amendments being proposed. The corporatisation of the National Ports Authority would have also adversely affected our borrowing programme and would undermine the synergies of operating freight transportation on an integrated platform.

With the new political administration now in place, we hope that the comfort of the assurance will be further supported by the requisite amendments and, to this effect, Transnet remains ready to assist in this effort.

The Act also provides for the establishment of a Ports Regulator. This has been in place for some time now. Directives on the regulator's approach to economic regulation have yet to be finalised. The National Ports Authority submitted its tariff application for 2010 in August 2008, but in the absence of a decision by the regulator at the start of the 2010 financial year, Transnet had no option but to proceed with the implementation of inflation-adjusted tariffs. Again, the regulatory uncertainty which continues to prevail could prove costly to port investment going forward. Further, we trust that the directives will be finalised soon and that, when finalised, they will support and increase Transnet's ability to roll out the much needed investment that is planned for the port system, much of which is already under way.

Rail

Rail economic regulation remains on the policy-makers' drawing board. Transnet wishes to sound a word of caution again: it is important that such regulation enables the critical investments that have to be made in South Africa's core rail network infrastructure and rolling stock. In addition it would be inappropriate to provide economic regulation on rail without considering the impacts on competition with road transport.



Construction under way at the Port of Ngqura

Opportunity outlook

In the short term, the Company will continue with the task of implementing its current strategy with a view to realising the growth opportunities that it has been positioned for. Simultaneously though, our eyes are on the long term: work is under way on developing an Africa strategy to facilitate intra-African trade by improving connectivity in the region; the creation of a regional hub port and enhanced short sea shipping service along the coast of Africa which will significantly improve the competitiveness of the region's manufacturing capability; and formulating Transnet's carbon reduction strategy to ensure we join hands with those leading-edge businesses that are playing their part in climate change. Further, having agreed with our Shareholder to ringfence the secondary rail network which is currently under-utilised, we will be rolling out opportunities in this network for private sector involvement with the view of promoting the extension of rail in freight transportation. Indeed, this would be the continuation, not the end, of our strategy for mutually beneficial partnerships with the private sector.

Prospects

The marked decline in economic activity in South Africa has negatively impacted volumes handled by Transnet and these conditions seem likely to persist for the next financial year. Nevertheless, the Board has implemented measures to reduce costs, improve efficiencies and pursue certain volume opportunities. Therefore, we remain cautiously optimistic of another credible year.

Appreciation

In the past year, our country has experienced two sets of far-reaching changes: first, the political administration changed; and second, large swathes of the global economy, including our own economy, slipped into a deep recession – in South Africa's case, this is the first time in 17 years. The latter has dampened demand for the commodities being produced by some of our leading clients. Output has been cut and millions of jobs have been shed as companies around the world battle to cope with the deteriorating economic situation. Transnet has also been impacted by this. However, I am pleased that years of investment – in prudent and vigilant risk management; continued investment in our people and infrastructure and equipment; and ethical and principled leadership – have paid off. For this, I am grateful to many people. In no particular order, I have to thank my colleagues on the Board; their wise counsel is assuring and makes the Chairmanship of this Company an enjoyable task; the members of the Executive Committee; South Africa is blessed to have such a diligent, committed and professional team leading one of its most important assets; and the thousands of our employees and their families.

During the year, we reluctantly acceded to the wish of Ms Ramos, the Group Chief Executive of Transnet, to leave the Company for a career in banking. A testament to continuity has been the seamless transition since Ms Ramos's departure and the Company has not missed a beat. A special thanks to Mr Wells, the Acting Group Chief Executive, for his support and the able way he and the team have managed the Company since February 2009.

The foundations of today's Transnet were built with the support of many people who no longer have association with the Company. These include Mr Alec Erwin, the former Minister of Public Enterprises (2004-2008) and his successor, Ms Mabandla (who retired after the elections); Mr Yunus Carrim (former Chairman of the Portfolio Committee on Public Enterprises and now Deputy Minister of Cooperative Government and Traditional Affairs) and his successor, Ms Fatima Chohan.

We are grateful to the continuity being provided to the changes in the political leadership of the Shareholder department by Ms Portia Molefe, the Director-General, and her team of officials at the Department of Public Enterprises. We look forward to the shareholder's leadership of newly appointed Minister Hogan and Deputy Minister Godongwane.

I wish to thank the growing universe of investors, bond holders and financiers who are showing rising levels of confidence in the future of the new Transnet. Their confidence is not misplaced – this is a great investment story with exciting prospects.

A special "thank you" to our clients and customers for working constructively with us to optimise our business in this downturn. We will not rest until they are all consistently satisfied with the services we provide!

And, finally, our deepest condolences to the families of the 13 colleagues who died tragically on duty during the year; we are doing everything to prevent a repeat of the incidents that result in loss of life.

FTM Phaswana
Chairman

Port of Port Elizabeth

Group Chief Executive's review

Chris Wells
Acting Group Chief Executive

Introduction

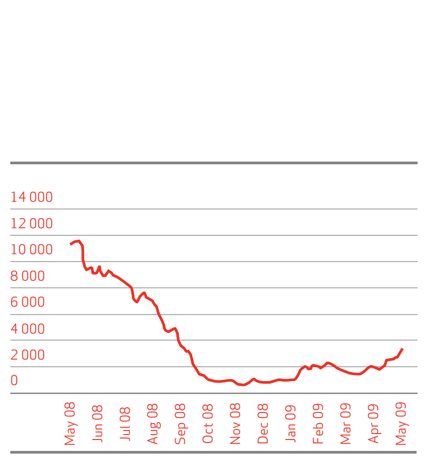
Transnet's key role is to assist in lowering the cost of doing business in South Africa and enabling economic growth by providing appropriate ports, rail and pipeline infrastructure and operations in a cost-effective and efficient manner and within acceptable benchmark standards.

The economic downturn has resulted in certain freight volumes, particularly the general freight business at Freight Rail and containers at ports, being well below levels of a year ago. Nevertheless, Transnet remains committed to the roll out of its R80,5 billion five-year infrastructure investment programme. This fulfils one of Transnet's strategies of creating capacity ahead of demand to enable growth.

To promote better customer service and to increase efficiency, Transnet has focused on reengineering its logistics network. This has resulted in us putting in place multi-disciplinary teams which focus on optimising the movement of freight along the key logistics corridors in South Africa. This structure has already resulted in improved customer service, reduced costs and better utilisation of assets. However, the process is still relatively new and significant opportunities for improvement have been identified.

Increasingly, investors are injecting funds into the business in support of Transnet's funding programme, reflecting a growing confidence in the Company's strategic and operational competencies as well as the bankability of its project portfolio. Since the start of the Capital Investment Programme, 21 projects have been launched, some are currently in progress, and some have been successfully completed. Investment spending for the year reached record levels, with a 22,8% increase in spend compared to the previous year.

In the year ahead, Transnet will continue to proactively pursue optimal funding options both domestically and internationally. It should be noted that Transnet has raised the funding required in the debt capital markets based on the strength of its own balance sheet and has not used Government guarantees since 2004.



Baltic dry index – One-year performance

Operating context

The sharp decline in demand for commodities and ship-borne freight was demonstrated by the major fall in the Baltic dry index, an indicator that reflects the price of available ship capacity for dry bulk freight, which fell more than 90% from its peak in mid-2008. The decline resulted from available ship capacity exceeding demand due to lower bulk volumes.

Demand for the main export commodities – iron ore and coal – remained robust throughout the cycle, reflecting the competitiveness of South African producers and the additional advantages created as a result of lower shipping costs. Other steel-related commodities fell sharply with manganese volumes, for example, falling by 14% year-on-year, broadly reflecting the extent of the volume decline for commodities in that sector.

South African exports are particularly exposed to the developed economy markets which account for four out of our five top export destinations. The slowdown in developed markets, which had been apparent from early 2008, accelerated sharply from September onwards. This has had a severely negative impact on the global container market, which had witnessed strong volume growth for more than a decade. Drewry Research, which tracks supply and demand growth, expected trade to be up by 7,2% in 2008 and now forecasts growth of just 2,8% in 2009. For Transnet, container and automotive volumes handled by Port Terminals declined by 12% and 24% respectively during the second half of the year compared to previous year's levels and Freight Rail's general freight volumes declined by 19%.

Transnet responded rapidly to the changed economic environment, which negatively impacted volumes moved and handled by all operating divisions, except for Transnet Pipelines. The swift response largely entailed a broad suite of actions, including aggressive cost reduction – including a freeze on recruitment, reduction in overtime, radical reduction of administration costs and a focus on priority initiatives only.

Transnet is committed to investing at least R80,5 billion in infrastructure capacity in the next five years, albeit with delayed phasing-in of certain investments given the lower volume growth projections. The focus remains on priority projects where capacity needs to be created to prepare for the pending upturn when demand for commodities improves.

Transnet remains committed to invest wisely in the creation of appropriate and cost-effective capacity for all our customers ahead of demand. This will be done on the strength of the balance sheet. Transnet will also consider mutually beneficial private-public partnerships with all roleplayers, including clients, which create value and make both strategic and commercial sense. Future demand for capacity must be reviewed in the context of affordability by Transnet.

Apart from its cost-reduction initiatives, the deteriorating economic environment also saw the Company focusing anew on productivity and efficiency improvements. We also looked for manifestly better ways to manage the business during the downturn and beyond to position it for growth. The Company has, for instance, introduced numerous performance improvement initiatives, including the Dynamic Management and Planning Framework which focuses on monitoring the Company's key cash flow generators and performance indicators on a weekly basis. It tracks volumes and revenue results and estimates and provides detailed monthly and annual forecasts, thereby enabling management to make appropriate and timely decisions to safeguard the financial parameters as set out in the business plans. Simply put, the value of this system is to heighten Transnet's sense of vigilance and to enable us to introduce proactive strategies to defend the Company's position in a difficult and rapidly changing environment, particularly during the recessionary economic conditions. This is especially critical given the Company's determination to invest R80,5 billion over the next five years.

The severity of the economic downturn has caught many by surprise. Of particular concern is the recent performance of the mining and manufacturing sectors, which account for the bulk of Transnet's business. Notwithstanding the impact of the downturn, Transnet is maintaining its commitment to the implementation of its growth strategy, especially investing in commodities where there are growth opportunities. South African commodity producers remain internationally competitive and their cost advantages will be heightened as a result of the significantly lower ocean freight rates that are expected to persist long after the global economic recovery. Furthermore, the shifting patterns of trade and shipping capacity in the liner shipping market creates opportunities to capture additional transshipment traffic. Domestically, low market shares in key sectors such as domestic coal, containers on rail and liquid bulk provide growth opportunities in spite of the overall decline in volumes.

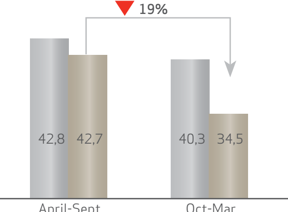
Transnet views the downturn as a temporary, albeit severe, setback. Accordingly, it will use the opportunity to improve operational efficiencies to position Transnet for growth in the future.

Financial results review

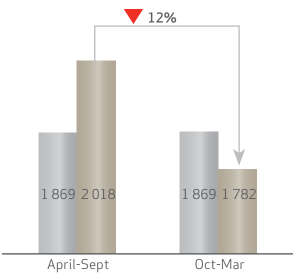
The review period can best be described as a "tale of two halves" due to the rapidly deteriorating global economic environment which was evident from September 2008. The first half was one of growth and the second half, one of decline. The graphs on the right illustrate this trend.

Revenue for the year ended 31 March 2009 increased by 11,6% to R33,6 billion compared to the prior year. The revenue increase was materially impacted by the new coal export tariff which was backdated to July 2008. This tariff was agreed with the coal industry after three years of below-inflationary increases. Adjusting for the revised tariff, revenue would have increased by 8,6%.

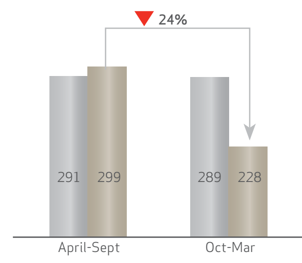
Earnings before interest, taxation, depreciation and amortisation (EBITDA) increased by 3,0% to R13,2 billion for the period resulting in an EBITDA margin of 39,3% (2008: 42,6%) driven by a combination of productivity improvements and cost-saving initiatives. Operating expenses grew by 18,0% to R20,4 billion. The cost increases, which were budgeted for, arose from the higher cost of fuel, electricity tariff increases and higher steel prices which impacted the cost of maintenance materials.



GFB (million ton)



Containers ('000 TEUs)



Automotives ('000 units)

- 2007/08
- 2009/09

All the operating divisions increased profit compared to the prior year, with the exception of Port Terminals which was adversely impacted by the sharp decline in container, break-bulk and vehicle volumes in the second half of the year.

Cash generated from operations at R13,5 billion remains strong and is marginally higher than the prior year. The cash interest cover of 4,0 times remains above targeted levels.

Shareholder's equity grew to R58,3 billion over the period, reflecting a 14,5% improvement. This shows the improving financial strength of the business and the trend underscores Transnet's commitment to create value for the Shareholder.

Gearing during the period increased from 29,7% to 36,2%, but is still well below the 50% ceiling target. Consequently, there is significant future capacity to fund the Capital Investment Programme from the debt capital markets.

The Company has once again achieved a new record in its capital expenditure programme. Transnet spent approximately R19,4 billion in capital, 22,8% higher than the prior year. This is in line with the strategy of creating appropriate capacity ahead of demand.

Operational review

The review period has been a challenging time for the Company. I am gratified however to report that the investment we made over the years in building a company to be resilient through all economic cycles has paid off. All operating divisions showed agility and were able to adapt to the economic slump experienced during the year. Crucially, we also saw the benefits of transforming into a focused and well-managed freight transport company. Both Transnet's operating model, as well as the corporate strategy, have proven to be sound and appropriate. Unfortunately, the downturn negatively impacted the volume trends compared to previous levels.

The impact of lower volumes was pronounced at Freight Rail's GFB which had shown an encouraging growth trend during the last financial year and the first half of the 2009 year. It achieved a total of 77,2mt for 2009, 9,5% below aspirations of 85,3mt and 7,2% below the 2008 performance of 83,2mt. The bulk of the loss occurred in commodities such as manganese, steel, ferrochrome and chrome – areas where Freight Rail was beginning to make strong inroads.

Overall railed container volumes continued to mirror the GFB performance, recording 37 914 twenty foot equivalent units (TEUs) being moved against the budget of 41 854. Overall performance for 2009 was 7% below budget and 2% below 2008 actual levels. Still, this remains an area of significant opportunity to gain market share from road competition.

A market share growth initiative, targeting containers and piloted on the Natal Corridor (Natcor), achieved demonstrable success. Container trains increased from seven per day to 17 per day. A new container operating model has been formulated, integrating Port Terminals and Freight Rail's operations to provide port-rail synergy. Importantly, the customers' satisfaction with the service is leading to significant growth opportunities in existing market share.

Freight Rail continued to sign up new customers on the GFB and to improve service levels with existing customers. Highlights have included the conclusion of a ramp-up agreement with Eskom, the electricity utility, on the Majuba line. This will see the current 4mtpa increase to 9mtpa. Freight Rail also increased its Eskom trains from a previous best record of 28 per week to 35 trains per week. It ramped up trains for fuel customers – such as BP, Shell and Engen – from five to seven trains per week. Freight Rail has also signed agreements for new klinker volumes with the cement industry.

On the Coal Line, Freight Rail railed a total 61,9mt (2008: 63,5mt). Despite the fall in coal volumes railed, due to product shortage and some operational issues encountered on our part, the Coal Line's improved performance of 1,4mt per week was sustained during the review period until the mines were unable to provide sufficient coal. We now have capacity to rail 10% more tonnage – that is, approximately 70mtpa. However, the biggest constraint at present is product availability. The Iron Ore Line achieved 36,8mt (2008: 31,9mt). Also, record tonnages were achieved on the Iron Ore Line following the implementation of more 342-wagon trains on the line. Freight Rail is currently operating 30 such trains per week and, consequently, has achieved cost savings of R93 million. This is currently the world's longest heavy haul production train.

Collaboration with foreign clients, such as Botswana Railways, Swaziland Railways and NLPI in Zambia, have increased. Agreements for improved business, albeit off a low base, are in place.

The poor economic conditions negatively impacted volumes handled by the ports. At our container terminals, the lower than expected import/export volumes were partially offset by transshipment volumes being 48% higher than planned. Total container volumes for the year, inclusive of transshipments, reflected a negative 0,2% growth on the prior year from 3 ,72 million TEUs to 3,71 million TEUs in 2009.

The automotive sector volumes were hit by high interest rates domestically and the slump in global demand due to the global financial crisis. The industry experienced ongoing decline in the level of new vehicle sales compared to 2008 and this trend is expected to continue. Major manufacturers accelerated export programmes to offset the fall in local demand. Although the actual volumes were 16,1% below target for the year, they were only 3,7% below the 2008 volumes.

Despite the declining volumes, port efficiencies improved during the year. For instance, berth occupancy was within the targeted range of 44%; at the Durban Container Terminal (DCT) moves per crane hour rose to 23 from last year's 22; and at Durban Pier 1 they increased to 24 per hour (2008: 19). Still, we are by no means satisfied with this performance. We believe we can do more; and we are working to achieve higher standards that will lead us to be comparable to international best practice.

Operating division performance

Freight Rail

Freight Rail is the largest division in Transnet accounting for about 55% of total external revenue and, therefore, it continues to receive significant management attention.

In an environment of declining volumes in its GFB, Freight Rail intensified its focus on pursuing opportunities for volumes (such as coal to power stations, containers, grain and timber); cost reduction; enhancing service levels; and improving operating margins. Efficiency gains were once again a key management priority.

In the first half of the year, we focused our GFB assets on achieving growth in critical flows of commodities. These commodities included manganese ore, rock phosphate, containers, automotive, chrome ore, magnetite and petroleum liquids.

In the year ahead, our strategic focus for Freight Rail will be to harness volume opportunities – including the transport of more export iron ore, domestic coal and moving more containers on rail – as well as securing a third reduction in safety incidents and safety related costs.

In addition, significant attention will be directed at improving customer service and satisfaction as well as efficiency and productivity improvements.

Performance highlights – Freight Rail:

- Revenue increased by 12,6% to R18,7 billion (Freight Rail's revenue was significantly impacted by the finalisation of the new export coal tariff).
- EBITDA increased by 11,0% to R5,7 billion.
- Capital investments reduced by 6,4% to R8,6 billion.
- Weekly export coal output escalated from an average of 1,1 million tons in 2005 to a record weekly throughput of 1,4 million tonnes achieved in November 2008.
- On the Natcor, transit times were reduced from 24 hours to 17 hours between Johannesburg and Durban.
- The National Command Centre was officially opened during this period. This facility contributes to the operations philosophy of a '24 X 7' nerve centre with all key decision-makers under one roof.

Rail Engineering

Rail Engineering continued to establish itself as the major service provider in the South African market for maintenance, repair, refurbishment, conversion and repair of locomotives, wagons and coaches. Rail Engineering is the main supplier of these services to Freight Rail, the only domestic mainline railway operator. This industry leadership position has been achieved through the leveraging of core competencies and strategically positioned factories and maintenance facilities alongside the key transport corridors. Rail Engineering currently has close to 100% share of all Freight Rail business for wagon and locomotive products and services.

Rail Engineering's external revenue reflected an increase of 32,9% to R1,4 billion mainly due to the increased number of coach upgrades conducted for the Passenger Rail Agency of South Africa (PRASA). EBITDA for the year fell due to the decrease in backlog maintenance and lower margins from Freight Rail.

The focus of the last three years – during which R6 billion was spent by Freight Rail on maintenance – is yielding the desired results. Availability of locomotives and wagons has improved. For example, locomotive availability improved in the GFB to 88,4% (2008: 86%); on the Coal Line it rose to 89,6% (2008: 89%); and on the Iron Ore Line it remained at 86%.

Reliability, as measured by faults per million kilometre travelled, is also showing a steady improvement.

Performance highlights – Rail Engineering:

- Revenue increased by 0,9% to R8,2 billion.
- EBITDA reduced by 36,1% to R764 million.
- Capital investments reduced by 25,7% to R568 million.
- Availability and reliability of rolling stock has been improved.
- The 'proudly Transnet' diesel locomotive, Class 39-200 built in Koedoespoort, was unveiled.
- 10M5 coaches and Business Express coaches were delivered for PRASA.
- Kei Rail coaches were produced for the Eastern Cape Government.
- Lean manufacturing was launched on the maintenance lines.
- The new School of Rail Engineering was launched.

Group Chief Executive's review (continued)

Performance highlights – National Ports Authority

- Revenue increased by 3,9% to R7,1 billion.
- EBITDA increased by1,2% to R5,2 billion.
- Capital investments increased by 54,9% to R4,2 billion.
- The Durban entrance and channel widening project is on track and expected to be completed next year.
- The Cape Town Container Terminal expansion is on track.
- Security upgrade projects commenced at all ports.
- The first vessel carrying project cargo called at the Port of Ngqura.
- All ports were dredged to promulgated depths.
- Shipping delays, as measured through pilot hours, improved from 2,24 hours in 2008 to 1,90 hours in 2009.

Performance highlights – Port Terminals:

- Revenue increased by 4% to R5,0 billion.
- EBITDA reduced by 6,5% to R1,7 billion.
- Capital investments increased by 59,1% to R3,1 billion.
- The Cape Town Container Terminal expansion project is well advanced. This will double capacity from the existing 700 000 TEUs per annum.
- Dual loading operations at the Saldanha Iron Ore terminal resulted in productivity per hour being well above the contractual requirement of 5 000 tons per hour. Now, two shiploaders service a vessel instead of one. The average loading rate for the 12 months ended 31 March 2009 improved to 5 954 tons per hour (35% above the prior year's performance of 4 400 tons per hour and 19% above the contractual requirement).
- Equipment refurbishment and reengineering at the Richards Bay Dry Bulk Terminal resulted in a 6% improvement in average loading productivity (tons loaded per hour), from 612 tons loaded per hour in March 2008 to 651 tons loaded per hour as at March 2009.
- The number of planned maintenance jobs, as a proportion of all maintenance undertaken during the year, increased to 78% from 75% in March 2008.
- Implementation of the "5-S" programme has assisted in consistently maintaining the disabling injuring frequency rate (DIFR) below the 0,90 target. The DIFR rating for 2009 is a phenomenal 0,85.

Performance highlights – Pipelines:

- Revenue up 13,2% to R1,5 billion.
- EBITDA up 6,7% to R1,0 billion.
- Capital investments up 220,5% to R2,8 billion.
- Volumes transported during the year increased to 17,2 billion litres as a result of the introduction of drag reducing agents (DRAs) into the pipeline.
- Gas volumes increased by 4,4% compared to the prior year.
- Construction on the NMPP has started.

National Ports Authority

The National Ports Authority also did not escape the global drop in demand for imports and exports (including volumes handled by private terminal operators), especially for containers which recorded no significant growth compared to the previous year. Break-bulk volumes declined by 27,3% compared to the previous year's levels; and the number of vehicles also declined by 9,1% from the previous year. However, we recorded satisfactory performance in the dry bulk sector (which includes export iron ore and coal), which was at similar levels as the previous year. Liquid bulk, on the other hand, showed a growth of 11,8% compared to the previous year.

Most significantly, the National Ports Authority saw some far-reaching changes in its regulatory framework and the division is embedding all compliance processes to be in line with the National Ports Act which came into effect two years ago.

The Act also introduced the Ports Regulator whose main functions are to:

- Exercise economic regulation of the port system in line with Government's strategic objectives which includes the annual approval of the National Ports Authority's tariffs;
- Promote equity of access to ports and to facilities and services provided in the ports; and
- Monitor the activities of the National Ports Authority to ensure that it performs its functions in accordance with the Act.

This division operates in an environment of regulatory uncertainty. Given that directives have yet to be finalised, the National Ports Authority submitted its tariff application for 2010 last August on the basis of draft directives. In the absence of a decision by the Ports Regulator at the start of the financial year, Transnet proceeded with inflation-adjusted tariffs, even though this increase results in revenue that falls significantly short of what is required to sustain current port infrastructure investment.

Port Terminals

Port Terminals, which operates 15 terminals across six ports, faced a challenging period due to the economic downturn. The division experienced a decline in volumes following five years of consistent growth.

The decline in volumes included the container sector – which has grown by an average of 7% over the last five years – where volumes fell by 0,2 % compared to the prior year. The container business contributed 59% and 62% to Port Terminals' revenue and EBITDA, respectively.

The division's R3,1 billion capital investment, representing a 59,1% increase on the prior year, included the construction of the 800 000 TEU Ngqura Container Terminal which is expected to be operational in October 2009 as well as the expansion in both the Durban and the Cape Town container terminals.

Significant strides were taken in Port Terminals' efficiency drive with average moves per gross crane hour (GCH) at the Durban container terminals (DCT and Pier 1), improving by 5% and 26% respectively, during the period. DCT achieved average moves per GCH of 23, while Pier 1 achieved average moves per GCH of 24 – a significant achievement taking into account the fact that Pier 1 was only operationalised during November 2007.

Pipelines

Pipelines is the recipient of Transnet's single biggest capital investment, namely the New Multi-Product Pipeline (NMPP) between Durban and Gauteng. Construction has commenced on the inland sections of the NMPP and steel requirements for the trunk line have been procured. We have received environmental authorisations to build the inland portion of the NMPP.

The environmental impact approval for the trunk line from Durban to Gauteng was received on 10 February 2009 from the DEAT.

Pipelines, which is regulated by the National Energy Regulator of South Africa (NERSA) faced some serious regulatory challenges. These challenges relate mainly to a lack of certainty around the setting of tariffs.

Pipelines' tariff increase application for 2010 was rejected by NERSA. Instead, the regulator decreased tariffs by 10,4%. The decrease is of a temporary nature. It is caused by the fact that the methodology used by NERSA in determining the tariffs to be charged excludes assets under construction from the regulatory asset base until these are brought into use which, in the case of the NMPP, is expected to occur progressively until the 2012 financial year – the project's completion date in terms of the licence conditions. Accordingly, a significant increase in tariffs will result when the NMPP is fully in use.

Whilst this timing shortfall has been alleviated through our funding contingency plan, the inconsistency in the application of the methodology makes planning for optimal funding solutions more challenging as cash flows cannot be predicted.

Strategy implementation

Strategic balance sheet management

During the 2009 year, the programme for disposing of non-core assets as part of the strategy to focus the Company on freight transport continued and is now, bar the disposal of non-core properties, nearly complete. Autopax Passenger Services (Pty) Ltd, the bus service, was sold for R1 to the PRASA, formerly the South African Rail Commuter Corporation, effective from 31 March 2009. The sale agreement for the transfer of Shosholoza Meyl, the long-distance passenger rail service, was concluded at a purchase price of R100, paving the way for this entity to become part of PRASA, the integrated public transportation system. In addition, Transnet received R500 million from PRASA to compensate for last year's operational costs. The effective date for the transfer was 31 March 2009.

South African Express Airways (Pty) Ltd, the wholly owned regional airline, was sold for R140 million to the Government. The transfer became effective on 1 April 2007 and was concluded in the early part of 2009. Loan accounts amounting to R336 million were also repaid.

During the year, we disposed of our 15% holding in Neotel (formerly the Second Network Operator) for R135 million to the Tata Group.

During the year, we sold a number of non-core properties to the Department of Public Works as well as other identified properties to the state-owned Servcon and other institutions, releasing some valuable properties for national housing. These sales raised R191 million.

Additional properties will be sold during the 2010 year as part of our property disposal strategy. During 2009, we deferred the planned sale of the Carlton Centre, our headquarters and one of South Africa's leading retail centres. However, we have completed all preparatory work, including the requisite governance approvals, making it possible to launch the sale process once a window of opportunity opens in the market.

It is anticipated that Luxrail, which operates The Blue Train, our world renowned hotel-on-wheels business, will be sold during the next financial year and negotiations for the disposal or restructuring of arivia.kom, the associate company which provides IT services to Transnet, are continuing.

The conclusion of the disposal of non-core assets has meant that executive management's attention can now be totally focused on the strategic management of our freight business for the benefit of all Transnet's stakeholders. The worsening economic downturn has made this task even more important. It is, in part, against this background that we introduced a Dynamic Management and Planning Framework and reporting system in all the divisions of the Company.

Overview

Each year, Transnet, through its Board of Directors, signs a Shareholder's Compact with its only Shareholder, the Government of the Republic of South Africa represented by the Department of Public Enterprises (DPE). It is from this Compact that the Company derives its mandate. This mandate is then translated into a strategy and the strategy is then tabled each February to the DPE as a corporate plan or business plan.

Transnet's strategy continues to be guided by our mission of lowering the cost of doing business in South Africa through the provision of port, rail and pipeline infrastructure and operations in a cost-effective and efficient manner and within acceptable benchmark standards. Fulfilling this mission depends on continued sustained growth in volumes and market share and this provides the context for the implementation of Transnet's growth strategy.

The 2009 financial year marked the first full year of Transnet's strategic transition from turnaround towards growth. Several key interventions were implemented to improve commercial and operational integration while continuing to strengthen operational efficiency and human capital development as well as enhancing financial and risk management. The focus on integration has yielded significant benefits, allowing Transnet to gain market share and open up certain markets in spite of the rapidly worsening economic environment experienced during the second half of the financial year. Continued focus on the reduction of operating costs and on operational efficiencies has enabled Transnet to record a commendable set of financial results in difficult circumstances.

Steady improvements in operational productivity and efficiency and enhanced customer centricity will continue to characterise Transnet's strategy going forward. In addition, opportunities exist to expand into new markets such as international transshipment and the provision of domestic intermodal solutions. The recent decision in respect of the concessioning of the low density rail network – alternatively called the secondary network or branch lines – will allow for more efficient feeder and distribution services, mainly for rural areas which will also contribute to growth of traffic on the core rail network (also see **redirecting business** in this review.)

Thus, Transnet is well-positioned for strong growth in the future and to be a key enabler of freight transport and logistics capacity when South Africa resumes GDP growth when world economic conditions improve.

Funding strategy

Overview

Transnet's funding strategy is, to a large extent, dependent on the Capital Investment Programme. The main objective of the funding strategy is to ensure that Transnet has adequate liquidity to meet all its operational and capital expenditure requirements cost-effectively. This is being executed within the Board-approved Financial Risk Management Framework (FRM), which includes the management of financial risks and the lowering of the cost of funding. To ensure that funds are available at the right time and at an acceptable cost, the Company continuously monitors broader global and domestic economic and market conditions and constantly interacts with key internal and external stakeholders. The funding strategy builds on the achievements to date, including all lessons learnt. It seeks to establish Transnet as a reliable and credible borrower which, albeit state-owned, issues debt on the strength of its balance sheet without any Government guarantees to achieve the following objectives:

- Minimise market risk, especially foreign exchange and interest rate risk;
- Reduce the weighted average cost of debt;
- Extend the duration of the debt portfolio;
- Optimise asset and liability management;
- Maintain the liquidity of Transnet bonds;
- Diversify the investor base;
- Diversify sources of funding; and
- Continue to build Transnet's yield curve.

Achievements

Having launched our domestic bond programme in 2007, the review period saw us implementing the other elements of the funding strategy. Highlights of the strategy included the fortnightly tapping of the domestic bond market; our funding from the international markets; and a series of rand term loans with domestic and international banks and financial institutions.

An amount of R7 billion was raised by means of three-year rand term loans in March and April 2009 at competitive spreads above three months JIBAR. Given the state of the global credit markets and scarcity of liquidity at the time, this was a new positive strategic step. This is part of our strategy to create liquidity for Transnet ahead of the specific need in these uncertain times so as to reduce our dependence on the commercial paper programme which is used for short-term funding needs.

In a first for the new Transnet, a loan facility of ¥35 billion was signed with the Japan Bank for International Cooperation (JBIC) in March 2009. This loan has a two-year draw down period and a 10-year six-monthly amortising repayment. It is specific to the funding of the widening and deepening of the Durban harbour entrance channel and the sand bypass project. The port is a vital link to facilitating trade between South Africa and Japan. This significant investment from Japan reflects confidence in Transnet's business model, and indeed, in South Africa.

A domestic bond tapping programme on existing bonds – namely TN17, TN27 and the latest TN23 – was launched to the market with the intention of raising R600 million per month. This strategy is working well and, by year-end, Transnet had increased this amount to R1 billion per month whilst market conditions and pricing were favourable. The strategy also includes the issuance of commercial paper (approximately R500 million) every two weeks to support short-term operational needs. After the end of the financial year, Transnet finalised the first rand-denominated Export Credit Agency (ECA) financing facility – amounting to R915 million – for the procurement of equipment for the ports of Durban, Ngqura and Cape Town. The proceeds of the funding, which is supported by Finnvera, the Finish export credit agency, will be used for the purchase of straddle carriers and Rubber Tyre Gantries for the Pier 1 Container Terminal in Durban, the newly upgraded container terminal in Cape Town and the port of Ngqura Container Terminal.

Plans are in place for the listing of the Global Medium-Term Note (GMTN) Programme. Last year, this had to be postponed due to the state of the global debt capital markets which had made pricing at that stage too expensive. The intention is to launch this programme – provided market conditions are favourable – during the next financial year. This programme will enable the issuance of bonds in the United States and European debt capital markets.

Discussions are also under way with a number of development finance institutions (DFI). These initiatives demonstrate Transnet's strategy of diversifying funding options both domestically and internationally.

We are heartened by the confidence that investors are continuing to show in Transnet by supporting the funding programme amidst the turmoil in the global credit markets. We see this as an endorsement of our corporate strategy, business and operating model, risk mitigation plans, management competence and expertise, and the attractiveness of our project portfolio.

Looking ahead and in anticipation of significant additional infrastructure projects, Transnet remains keen to explore other innovative funding solutions, including project finance and public and private partnerships. It remains our intention to maintain the self-funding model of Transnet and to ensure that all borrowings are made on the strength of our balance sheet. For this to continue, it means the Board-approved metrics – namely, to maintain a cash interest cover above 3,0 times and gearing below 50% – will continue to be our guide.

Enterprise-wide risk management (ERM)

Group risk

Effective and visible risk management has never been more relevant in a business than in the current environment. During the year, Transnet continued to embed its established Enterprise-wide Risk Management Strategy and framework for the management of all risks across the Group. The ERM process, which has been aligned with the growth strategy, is informed by global leading practices.

During the period under review, our risk management processes reached maturity stage, consistent with strong governance oversight, management, reporting and escalation of business critical risks to the appropriate governance levels including the Board and the Shareholder.

As such, we have a greater appreciation of the implications of all our regulatory risks, environmental risks, funding and liquidity risks, major capital projects risks, commodity cycles and volume risks, and safety and other operational risks. Furthermore, we are placing greater emphasis on managing risks in a more coordinated and dynamic manner.

The business continuity management (BCM) process is well established. It was rated as "established" by Ernst & Young, our internal audit partners, which implies that the core elements of BCM have been successfully implemented across the Company. The compliance function, which is aligned with the ERM process, is largely embedded across the Company. High-risk compliance requirements have been identified and analysed and mitigation plans have been developed. The focus is now on control self-assessments and providing assurance on the management of risks. Looking ahead, whilst there has been meaningful and pleasing progress, much still remains to be done in fully embedding the culture and practice of risk management into our day-to-day activities.

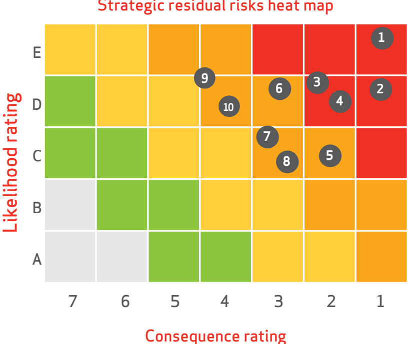
Safety

At Transnet we are committed to a safe and healthy workplace with strict adherence to our standard operating procedures including the Occupational Health and Safety Act, 1993. Our key drive is to achieve significant improvements each year. During the year, the Company's rolling disabling injury frequency rate (DIFR), the recognised measure of injuries on duty, improved to 1,09 compared to 1,25 in the prior year. This is a 12,8% year-on-year improvement. Still, whilst impressive, this rate falls short of our aspirations.

This was our worst year in terms of safety in four years. We remain deeply disappointed and saddened by the 13 employee fatalities (2008: 11) suffered during the review period. Our deepest condolences go to all the families and friends of our late colleagues. The Company suffered a R620 million loss in respect of safety costs for the 2009 year, an increase from R448 million in the prior year. The loss largely relates to equipment and excludes loss of revenue and other associated costs. Therefore, taken together, the loss is unacceptably high. Public fatalities increased to 197 in the year. Going forward, we will intensify our efforts to achieve a zero-fatality goal. We are not happy with the progress on improving workplace safety and, accordingly, the executive has agreed to target a quantum improvement in the medium-term, namely a third reduction in costs and number of incidents. To enable this, each division is implementing structured programmes to deliver this improvement.

Group top ten risks

Strategic residual risks heat map



- Priority I risk – Transnet Group CE and Board level
- Priority II risk – Operating divisions' CEO's level
- Priority III risk – General Managers' level
- Priority IV risk – Managers' level
- Priority V risk – Employees' level

Strategic risks

1. Revenue and volume growth
2. Non-compliance with safety and standard operating procedures (SOPs)
3. Economic regulation (Ports and Pipelines)
4. Funding and liquidity risk
5. Asset performance and maintenance regime
6. Delivery of capital projects on time and within budgets and affordability
7. Human resources capability to deliver on growth strategy
8. Environmental risks
9. Input costs – energy (electricity and fuel), steel, pricing and supply
10. Commodity and concentration risks

Transnet has historically transported asbestos minerals from the mining regions of South Africa to major markets, locally and for export (the last time asbestos was transported was in 1995). In doing so, the railway lines leading from the points of loading to the destinations have become contaminated from the spillage or the improper handling and storage of the asbestos materials. The recent expansions and upgrades undertaken within the Port of Durban have resulted in the uncovering of previously buried stockpiles of asbestos and the discovery of significant amounts of surface asbestos at various sites.

These conditions could, if not managed, result in possible adverse environmental and health problems for Transnet's employees and the general public. A number of sites were rehabilitated in the past, but these initiatives have not been sustainable as asbestos contamination continues to resurface or be exposed by normal operations and repair.

As a result of the expansions and upgrades, specialist inspections were conducted during the year on areas affected by the historical contamination. These identified, amongst others, crocidolite, amosite and chrysotile asbestos on the surface and within sub-surface soil.

Areas of contamination for Transnet may include, but not be limited to, the following:

- The loading and off-loading platforms as well as several facilities at depots;
- Polluted spots located along the main lines at corner bends along the railway lines;
- Polluted spots at the depots or shunting yards where track maintenance takes place; and where asbestos loaded wagons were stored/shunted.

In terms of the relevant legislation, Transnet has a legal obligation for the rehabilitation of the asbestos contamination since the enactment of certain legislation in 1998, and accordingly a provision amounting to R700 million has been recorded for the estimated costs of this restoration.

Renewed efforts to improve our safety record include visible leadership and supervision in embedding a safety culture and ensuring compliance with standard operating procedures (which are kept up to date with 'lessons learnt' and are easily accessible to all employees). Leadership and compliance activities are augmented by training programmes to create a strong base of skilled safety personnel; increased safety communication; safety management systems; appropriate organisational structures; and ongoing employee and public safety awareness programmes. Further, management and labour have formally partnered to tackle the safety challenge head-on. This partnership includes, but is not limited to, the designing and rolling out of a safety programme which is underpinned by the culture charter, our internal branding project.

We have already observed some pockets of excellence in the following areas: Port Terminals has been ISO 14001 (Environmental Management System) accredited at all of its terminals by the South African Bureau of Standards (SABS); Pipelines, Transnet Property and Port Terminals, completed the financial year without a single employee fatality; and Rail Engineering (Van Dyks Drift) achieved its 10th consecutive NOSCAR Award. We will continue to recognise and reward these and other exemplary safety performances and achievements of safety targets.

We have a well established sustainability platform which integrates principles of economic prosperity, social equity and quality environmental management. As discussed in our Sustainability Report (see pages 76 to 105 of this report), we are working across the Company to ensure increased accountability, stakeholder engagement, world-class performance, transparent reporting and environmental custodianship.

Transnet and the environment

Transnet cares about the sustainability of our environment. Bequeathing a safer planet, with a rich heritage to future generations forms a vital part of our strategies. For years now, we have embraced the importance of the environment in our operations and want to be recognised as a leading corporate citizen. In our Sustainability Report, we elaborate on both our approach to environmentally sustainable operations and our future plans in this regard.

Our aspiration is to go beyond compliance and to join other companies in the world that are leaders in practising sound environmental custodianship. Whilst we have made progress in creating environmentally sustainable operations and maintaining sound environmental standards, we believe there is room for improvement, especially in and around our ports. Apart from working closely with all the relevant authorities and regulators in improving our environmental management performance, we also plan to step up efforts in this area. Amongst others, we will be focusing on planned maintenance and housekeeping of our port, rail and container environments. In addition, we have commissioned compliance audits at all our major areas of operations in the coming year. More regular proactive audits are to be conducted to ensure absolute compliance with all applicable laws and regulations by all our operations.

One of our success stories can be noted at the National Ports Authority in Port Elizabeth, whereby we first observed hydrocarbon seepage at Dom Pedro Quay in 2001 and immediate corrective measures were instituted in collaboration with the oil industry. No further seepage was observed until June 2008 when a refurbishing team working on the Dom Pedro Jetty noticed an oil-like substance seeping through the seabed from under old sand bags. Although the National Ports Authority was not responsible for the oil seepage – as evidenced by laboratory tests – management took swift action to control the spread of further pollution by initiating a clean-up operation and appointing a team of environmental specialists to investigate the incident. Furthermore, the Oil Industry Forum has committed to meeting the National Ports Authority's deadline to finalise action plans and implement corrective actions.

We are also considering innovative and holistic ways to play our part in managing environmental risks such as climate change as well as the responsible use of energy and other natural resources. The impact of our carbon footprint will be carefully monitored and the focus will be on minimising any adverse impacts.

Reengineering and redirecting the business

Integrated performance metrics

Since the start of our turnaround strategy, the Company has been on a major drive to implement world-class productivity throughout the business. We have established key performance indicators to measure performance accurately and consistently in comparison to benchmarks and driving improvements to benchmark standards.

During the year, the Shareholder Value Add (SVA) framework was developed as an integrated performance metric and linked to the value drivers across the Group. SVA therefore integrates financial and operational performance indicators from each division into a single value driver model for the Group and is used as a basis for determining the key performance indicators for monitoring and reporting. This enables management to focus on the most important value drivers during performance dialogues to ensure the Group's strategic objectives are achieved.

Enabling rural renewal

In late 2008, the Transnet Board of Directors approved a strategy for the concessioning of Freight Rail's branch line network to private party operators. An implementation plan has since been finalised, and engagements are now underway with Government to ensure the sustainability of the business opportunities that will be offered to private operators.

The Transnet branch line strategy is directly aligned with Government's commitment to promote rural development, and Transnet is encouraged by the collaboration that is taking place with Government departments to ensure the branch line strategy's success. Once the necessary arrangements have been finalised with Government, the plan is to commence the branch line concessioning process in early 2010.

The branch lines comprise approximately 7 000 km of railway and are located in all provinces of the country. Some are active lines while others are currently closed due to inadequate volumes for Freight Rail operations. The majority of the active branch lines feed cargo into the core network. The core network, runs block trains on a hub-to-hub basis.

The branch lines are distinct from the core network in that they are characterised by: they carry relatively low volumes; they are suited to certain types of axle load, distinct types of train configuration; they are suitable for small-scale operators; and they usually incorporate multiple origin-destination points.

The concessioning of the branch lines offers a valuable opportunity to revitalise underutilised rail assets to encourage greater use of rail rather than road for the movement of freight, to support Government's rural development initiatives, and to tap into tourism potential in remote areas of the country. Transnet has committed resources for the forthcoming years to ensuring the success of this important initiative.

Procurement and BBBEE

The need for an efficient and cost-effective procurement and logistics function within Transnet has never been more critical to achieving growth, not only within Transnet, but within the country as a whole. We have invested a great deal of time and energy into skills upliftment, process optimisation and improving automation to ensure that we identify and secure the most optimal sources of supply for the range of products and services we require as a business.

Effective strategic sourcing of goods and services is vital to reducing the overall cost of freight transportation in South Africa and to rebuilding our infrastructure. Our strategic sourcing efforts over the past year have delivered sustainable year–on–year savings, which has resulted in Transnet exceeding its target of approximately R1,7 billion savings over three years. More importantly, this effort has led to a professional procurement culture which focuses on negotiations, strategic partnering, increased understanding of demand management and better procurement forecasting. Optimisation within the logistics and warehouse functions helped to reduce capital project time delays and overruns which, in turn, led to improved customer service on our main corridors.

Transnet Business Intelligence (TBI)

The TBI programme continues to improve the availability of relevant, accurate, timely and consistent information to support executive decision-making. Numerous projects have been completed and key achievement highlights include the following:

- Implementing financial planning systems and processes which form the basis for overall Transnet financial planning, forecasting as well as future enhancements;
- Implementing key elements of enterprise performance management (EPM) which aligns the strategic objectives with planning, monitoring and performance management in the Company as well as identifying the key measures;
- Enhancing the taxation (current and deferred) calculation process at key reporting periods through the integration of financial information into the taxation system;
- Rationalising various payroll systems within the Transnet support units;
- Reviewing and updating Transnet's cash management policies and procedures;
- Ensuring the availability of the Executive Dashboard that will form the basis for further sourcing of executive information for decision-making;
- Standardising capital projects and investment management processes across Transnet, underpinned by a system that enforces controls as defined by the business; and
- Standardising the rating and managing of risks and enabling centralised consolidated reporting.

Information Communication Technology (ICT)

The primary role of ICT at Transnet is to ensure strategic alignment of multiple business aspects through technology enablement. Among the key achievements during the review period has been the establishment of an Architecture Centre of Excellence (ACE) to ensure consistent application of IT standards across the Company, ending years of fragmented use of various, costly and incompatible technology platforms in the Company. Our efforts to ensure that best practices are followed and costs are closely monitored resulted in Transnet sustaining a better-than-industry benchmark for ICT costs relative to revenue and operating costs.

Commercial drive

The period under review was the first year in which we delivered integrated port-rail service offerings with a view to deliver more efficient integrated supply chain solutions.

Apart from re-packaging Transnet's service offerings, the Commercial Unit also seeks to forge strategic relationships with key corporate customers and offers them a single point of contact at Transnet. Since establishing the company-wide commercial function, we have achieved the following:

- Implemented a process of standardising contract terms and conditions with many customers and to cover services provided by our operating divisions into single customer contracts;
- Commenced the planned expansion of the manganese export channel to ensure the fair allocation of created capacity to existing and prospective customers;
- Improve customer relations management by creating a single centre to coordinate all major customer events.

The unit, which now manages the relationship with our key customers, is core to our efforts to position the Company for future growth through initiatives such as the container volume market share drive.

Functions

- EPM
- Business services
- Corridors
- Commercial
- Projects

Corridors

Example

Sentrarand
Kaserne
Newcastle
Danskraal
Durban
DCT

Yard
Depot
Port

Network

Beitbridge
Gauteng
Maputo
Sishen
Richards Bay
Durban
Saldanha
East London (EL)
Cape Town
Mossel Bay
Ngqura
Port Elizabeth

By implementing cohesive service and costing objectives, our broad-based black economic empowerment (BBBEE) expenditure has risen by 68% (R11,6 billion) during the year compared to the previous year. Other factors contributing to this increase included greater empowerment of local suppliers in the various regions; adherence to the Construction Industry Development Board (CIDB) principles; negotiating and contracting percentage improvements in suppliers' BBBEE level contribution; and improved reporting. In addition, social responsibility and sustainability are now common themes in negotiations and contracts.

For more than a year now, Transnet has been participating in the Competitive Supplier Development Programme (CSDP) – a Government-inspired initiative to localise the supply of imported equipment, stop capital leakage and promote industrial development.

The CSDP, which replaces the National Industrial Participation Programme, is being piloted for an initial three years. The programme encourages original equipment manufacturer (OEMs), which are supplying port equipment to express their commitments to the CSDP in the form of skills transfer, free training and the creation of local engineering and maintenance opportunities.

Transnet was the first SOE to have approved CSDP plans and remains an active participant in the programme.

Our major initiatives under the CSDP include the local assembly and engineering work performed by Rail Engineering in conjunction with OEM, Electromotive Diesel (EMD) in the acquisition of the 50 "like-new" locomotives. This key procurement partnership, with a total cost of R887 million, has resulted not only in significant skills transfer to enable increased local assembly and engineering of locomotives, but has also kept many people employed. In terms of the partnership, EMD has committed to the transfer of intellectual property to Rail Engineering in building a world-class traction motor assembly line-valued at USD15 million.

In addition, Transnet has contracted with Mitsui and its local partner UCW for the design, manufacture and delivery of 154 locomotives at a cost of R4,8 billion. A significant portion of the work is performed locally. Consequently, this has enabled the establishment of two world-class locomotive assembly plants in South Africa which has facilitated increased competition, skills transfer and employment opportunities.

We remain committed to participating in the CSDP as we continue to renew our locomotive fleet. In addition, the CSDP has led to a more invigorated relationship with some of our key international suppliers. The dialogue is now focused on joint initiatives, a renewed interest in innovation and change, and longer-term views of the suppliers' role within South Africa. Transnet is also spearheading the development of a Railway and Harbour Supply Chain Association which will provide opportunities for information exchange and networking between rail and port operators, their suppliers and relevant Government agencies.

From Vulindlela to integrated freight transport and logistics corridors

In the past, we have reported on the business reengineering programme known as Vulindlela (the Zulu word meaning "opening the way"). This was an internal programme focusing on efficiency and productivity improvements, safety improvement, cost containment, procurement, customer-orientation, maintenance and profit improvement. It was always envisaged that the programme would, once embedded in the business, be subsumed into the operating divisions and stop being centrally driven and monitored. This point was reached a while ago. Accordingly, the external advisers who supported the programme during its initial stages have largely withdrawn and divisions have now taken over the responsibility for managing the programme and are implementing the identified action plans as part of their day-to-day activities.

In keeping with our growth strategy, we have reorganised the Company to support integrated planning and investment along the freight corridors to improve customer service and gain market share (for example, in areas such as containers on rail). Therefore, during the financial year, we appointed a senior and experienced executive to lead specialist teams, each headed by a corridor General Manager to support the four primary freight corridors: namely, the Cape, Natal, Richards Bay and Sishen-Saldanha.

The primary focus of these corridor teams is to ensure that, within each corridor, there is a coordinated approach to planning, investment and operational strategies. This requires full alignment between operating divisions and the various customers that utilise the corridor. The team tracks volume flows from source through to the port for export and vice versa, unlocking bottlenecks and creating a culture of continuous improvement in the system.

Whilst the corridor structure is still being fully implemented, the focus on key commodity flows within priority corridors has already resulted in visible improvements in integrated planning and operations and customer service, both within Transnet and between Transnet and its customers. As the freight corridor structures become fully embedded in the organisation, we expect them to yield further efficiency improvements that will benefit both Transnet and its customers.

Business Services

With the introduction of the growth strategy more than a year ago, we have pooled certain core corporate services across the Group and now house them under a newly created corporate centre-based unit to be known as Business Services, led by a newly-appointed General Manager.

The inspiration behind this initiative was to underpin our efforts on reengineering, integration, productivity and efficiency improvements as contemplated within the growth strategy. Whilst Business Services, as a functional unit, is still in its infancy, it is envisaged that the basic structure will comprise procurement and supply chain management; information and communications technology management (including business intelligence); as well as other support services.

A decision was also taken to pilot and investigate the concept of a shared service for the human resources management function in the Company.

Capital Investment Plan

Transnet experienced yet another successful year, with investment of R19,4 billion (excluding the capitalisation of borrowing costs of R764 million). This represented an increase of 22,8% over the 2008 investment. Whilst marginally lower than our target, the figure is in line with our plans as well as targets agreed with our Shareholder.

In keeping with our plans, the bulk of the investment – some R10,9 billion or 56% – was allocated to expanding our operations by providing additional capacity while R8,5 billion or 44% was spent on maintenance of existing infrastructure.

Of the total invested in the year, R9,2 billion or 47% was invested in the rail sector and, of this, R8,6 billion was invested in Freight Rail, whilst R568 million was invested in Rail Engineering. About R7,3 billion was invested in the ports, with R4,2 billion invested in the provision of port infrastructure and facilities and R3,1 billion invested in the operations of Port Terminals. Investment in Pipelines amounted to R2,8 billion and mainly went towards the procurement of 700 kilometres of steel pipelines, pumps and valves. The remainder of the capital investment went to enhancing the specialist units.

Spending in 2009 included the following major projects:

Project name	R billion
– Infrastructure and rolling stock capitalised major overhaul costs	3,90
– The New Multi-Product Pipeline	2,60
– Coal Line expansion	0,49
– Iron Ore Line expansion	1,40
– Ngqura Container Terminal (berths, equipment, paving, etc)	2,23
– Acquisition of 50 'like-new' locomotives	0,25
– Acquisition of 110 dual voltage locomotives for the coal line	0,11
– Reengineering of the Durban Container Terminal	0,60
– Cape Town Container Terminal expansion	0,89
– Port Elizabeth manganese terminal refurbishment	0,31
– New container terminal at Durban Pier 1	0,17
– Widening and deepening of the entrance channel of the Port of Durban	1,09

Divisional split %

Capital Investments by division

(R million)

Division	R million
Freight Rail	8 593
Rail Engineering	568
National Ports Authority	4 237
Port Terminals	3 144
Pipelines	2 772
Other	68

Transnet's performance continues to support the rationale for establishing a dedicated unit, Transnet Capital Projects, to drive the implementation of the major projects (that is, those exceeding R300 million in value) and free up operating division executives to concentrate on the day-to-day management of their businesses. The successful delivery of the major projects within an ambitious and demanding Capital Investment Plan is testimony to the success of the model.

Since the start of the capital investment programme, 21 major projects have been launched – some are still in progress whilst others have been completed. Some of the other achievements during the past year were the three million lost time injury (LTI) free hours achieved at the Port of Ngqura and two million LTI free hours for RME (Rehabilitation, Maintenance and Emergency) port assignment in KwaZulu-Natal. Due to the environmentally sensitive nature of most of our ports, several studies were commissioned to determine the value of the affected ecosystem services in the ports of Durban, Richards Bay and Saldanha. This served to develop expansion alternatives and realistic offsets for the potential impacts from the proposed expansion.

The project lifecycle process, introduced a year ago to ensure a single, aligned, consistent capital project development and execution process across Transnet, has now been embedded.

In the following section, we review progress made in each of the major capital projects:

Sishen-Saldanha Iron Ore Line

Completed phases of the R5 billion project – designed for a projected capacity increase on the rail line to 47mtpa and the contracted export capacity at the port to 45mtpa – include the extension of 19 passing loops and the provision of an additional new passing loop. In addition, approval for the expansion of the Iron Ore Line to 60mtpa has been approved in principle by the Board. In January 2009, the 100th 342 wagon train travelled down the line. The first six of 44 new 15E locomotives are expected to enter service during 2009. The final stage of the project, which includes the reverse osmosis plant and the refurbishment of Stacker Reclaimers 1, 2 and 3, will be completed by mid 2010.

Cape Town Container Terminal

The R4,2 billion Cape Town Container Terminal project encompasses: the expansion of the terminal to double capacity in future years to 1,4 million TEUs; increasing the water depth in the harbour basin and berths; upgrade quay facilities; relocate the majority of the container stack areas closer to the berths; as well as provide a new truck staging area, gate automation and operating system.

Construction is in progress and Berth 601 will be operational by August 2009. Dredging works at the berth have been completed and all piling has been installed and the superstructure constructed. Fabrication of the rubber tyre gantries (RTGs) is in progress. Four ship-to-shore (STS) cranes have been erected on site and are awaiting slipping onto the quay. The main berth deepening and quay refurbishment contract has been awarded and the first civil stack reconfiguration contract is in progress. The reconfiguration of stack areas and the new staging area will improve operational efficiencies and double capacity with no increase in footprint.

Port of Ngqura

The scope of work includes the construction of the Ngqura Container Terminal Phase 1 and 2; as well as various buildings; rail and road infrastructure; and container handling equipment. The Phase 1 Container Terminal will be fully equipped to handle 800 000 TEUs per annum, with the first 630 metres of quay side being equipped with landside container equipment. Work on the port control, entrance plaza and terminal administration buildings is at an advanced stage and will be completed in the latter part of 2009.

The paving for container terminal Phase 1 has been completed and the first batch of RTGs and STS cranes has been delivered. A major milestone was achieved when a number of service vessels docked at the port, with one delivering the STS and RTG cranes "knocked down" components. Phase 1 will be commissioned at the end of October 2009 with all equipment and facilities in place. It will be exciting, at long last, to see this greenfields port begin operations in October 2009!

Port of Durban

Work on the R3,9 billion Durban harbour entrance channel widening and deepening is progressing well. On completion, this project will enable the port to handle the larger new generation ships as well as improve the safety standards to match international norms. The widening has been completed. Excavation for the north revetment has progressed well. Major milestones on the radar include the switch over to the temporary channel scheduled for May 2009; completion of all dredging works by September 2009; completion of the north side construction by January 2010; and completion of the south breakwater. The project close is scheduled for March 2010.

When completed, the new channel will be 225 metres at its narrowest point with a depth of 19 metres in the approach channel, 18 metres in the channel and 16 metres in the inner channels and port basins. The wider and deeper channel will accommodate container vessels with a capacity of up to 9 200 TEUs.

Durban Pier 1 Container Terminal

Phase 1 of the construction of the new container terminal at Pier 1 in the Port of Durban is in operation with the final delivery and commissioning of the Rail Mounted Gantry (RMG) equipment scheduled for completion by the end of May 2009. The project is scheduled for completion by the end of May 2009. Phase 1 of the project will increase the capacity of the Port of Durban container handling capacity by 720 000 TEUs per annum.

New Multi-Product Pipeline (NMPP)

The current Durban-Johannesburg Pipeline (DJP) is over 40 years old and operating at full capacity. Transnet is building the new pipeline to replace and expand major components of the existing pipeline distribution system with new infrastructure which includes 555 kilometres of 24-inch pipeline and 160 kilometres of 16-inch pipeline; four pump stations; a coastal terminal with a tankage capacity of 200 000 m^3; and an inland terminal capacity of 240 000 m^3. The project aims to ensure security of supply to the inland market for crude and refined petroleum products in line with the requirement of the Petroleum Pipelines Act.

The NMPP is designed in such a manner that capacity can be increased in phases over the years as demand increases to ensure that inland demand can be met until at least 2030. Petrol and diesel will be transported in batches in the NMPP, as is currently done in the DJP. Costs for the initial phase are planned at R12,6 billion.

Capacity will initially be 1 100 m^3 per hour and will ultimately increase to approximately 3 000 m^3 per hour on the 24-inch diameter main line.

The environmental impact assessment found that the project will not impact negatively on air quality or human health as there will be no emissions from the pipeline. Air quality will also improve as the pipeline will reduce the number of road fuel tankers leaving Durban, by about 60%, which will further reduce the greenhouse gas emission from fuel tankers where trucks idle for long periods of time due to road congestion. This will assist Transnet in reducing the carbon footprint of its operations and those of its customers; and safety on our roads will also be significantly improved.

Environmental authorisations were received for the 16-inch pipelines currently under construction in the inland network and approximately 73 kilometres has been completed. The environmental authorisation for the trunk line from Durban to Gauteng was received on 10 February 2009 from the Department of Water and Environmental Affairs (previously DEAT). A few notices to appeal were received but when the appeal period closed officially on 23 March 2009, only one appeal had been received. Once the Cabinet member responsible for Water and Environmental Affairs has attended to the appeals, the construction of the trunk line will commence.

The first phase of the project will be in operation by December 2010 and the completed project will be delivered on time by December 2011 as specified in the licence conditions received by Transnet from the regulator.

Several environmental permits – including water use licences and borrow pit permits – were also obtained from the Department of Water Affairs and Forestry and the Department of Mineral and Energy Affairs (as they were then called) respectively.

Locomotive acquisition programme

50 "like-new" locomotives

Initially, governance and contractor performance issues were experienced, resulting in the delivery schedule being delayed by 12 months. Five locomotives have, however, been completed and delivered to Freight Rail for testing. Based on the revised delivery schedule, the last locomotive will be delivered in October 2009 and accepted in December 2009. These locomotives are being assembled at Rail Engineering which is also completing some engineering work thereon.

110 Coal Line locomotives (19E)

Various production and manufacturing issues were experienced by the contractors, resulting in a 12-month delay. These issues have since been resolved. Three locomotives have been delivered to Freight Rail for testing to date. Another six are due for operational testing by mid-June 2009. The average planned rate of delivery is six to eight per quarter thereafter.

44 Iron Ore Line locomotives (15E)

The original delivery schedule was not met as the production process was linked to the 110 Coal Line locomotives. This resulted in an eight-month delay. In terms of the revised timetable, committed delivery for testing is now August 2009 while operational testing is to be complete by May 2010. The average planned rate of delivery is 7 in 2009 and 25 in 2010 and then the balance will be delivered in 2011.

212 diesel and electric locomotives

This tender was cancelled in July 2008 after a forensic investigation revealed certain procedural problems. All tenderers were appropriately notified of such cancellation.

100 fast-tracked locomotives

During the year, Transnet issued a separate tender to acquire 100 locomotives on a fast-tracked basis from OEMs to meet specific operational requirements. These locomotives are scheduled to be delivered by the latter part of 2010.

It is pleasing, however, to report that at least 70 new locomotives should be in operation by the end of 2009 and approximately 200 locomotives by the end of 2010. This will mean that by the end of 2010 approximately 10% of the locomotive fleet will be new and accordingly, it is expected that with the concomitant improvement in the availability and reliability in the locomotive fleet that customer service will significantly improve.

Overview

This programme, which lies at the core of our plans to improve customer service and increase volumes railed by Freight Rail, has been significantly delayed. Most of the challenges during the year related to delays from the OEMs. However, timely interventions by Transnet have resolved most of the issues.

To ensure similar issues are avoided in the future, a Locomotive Acquisition Steering Committee has been established to coordinate Transnet's tractive requirements so as to achieve the strategic business objectives as set out in Freight Rail's Board-approved fleet plan; ensure all governance and processes are correctly managed and suitably adhered to; ensure the effective and efficient procurement of locomotives; and to ensure that contract negotiation and final contract award have commercial risk mitigating strategies. In addition, representatives from the Transnet Internal Audit department have been included to ensure governance issues are complied with at all times.

Human capital

"Masihambe – living the culture charter"

Following a year-long process of employee engagement and mobilisation to define a winning culture for Transnet, the culture charter was unveiled to close on 30 000 employees across the Group in August 2008 through multiple launch events. The launches were intended to promote ownership of the charter amongst employees; create a strong sense of unity and pride in what employees have collectively achieved; and to further entrench and foster the "One Company, One Vision" philosophy.

The launches were a huge success, with employees and our labour union partners spontaneously embracing the "*Masihambe… Let's move together!*" song, which was composed specifically to create awareness for the seven 'key behaviours' contained in the charter.

The charter, best understood as an internal branding exercise, defines the behaviours that all Transnet employees will uphold and commit to in order to realise our promise of delivering on our commitments to stakeholders and to create the platform for sustainable growth.

The first scoring of the charter in September 2008 established the baseline from which to monitor progress in achieving our aspirational culture as well as indicating the most important cultural interventions that are required. We intend to measure our progress and commitment to the charter on an annual basis and to develop programmes that will start to embed and entrench our new culture.

The charter process, arguably one of the largest ever undertaken in the country, has attracted the world's attention. For example, the US-based Wharton Business School is considering writing this up as a case study for global best practice.

The culture charter comprises seven behavioural principles:

- We have a safety mindset.
- We have good communication.
- We treat each other with dignity and respect.
- We are empowered to perform in our jobs.
- We are business focused.
- We recognise and reward good work.
- We deliver on our promises.

Talent management and leadership development

Transnet has continued to emphasise its talent management processes and maintaining a talent management culture within the Company.

During the year, the talent management strategy was rolled out to all executives, senior leaders and frontline supervisors through training programmes and talent forums. Employee development action plans, succession plans and succession pools for senior leadership were developed.

The Transnet Navigator programme, our leadership initiative, continues with good impetus. The key objective of the programme is to raise the level of leadership competencies at strategic, operational and emergent levels in the Company. In 2008, a total of 1 680 managers attended the programme and, to date, the number of participants has been increased to 3 389 managers. Plans are under way to roll out the Navigators Phase 2 programme which would respond to specific business requirements as defined in the individual learning plans of employees. The philosophy revolves around providing a support framework for identifying, planning and implementing focused initiatives.

Skills development

One of the key drivers of organisational success is to harness and apply a high level of skills amongst the workforce. Transnet remains committed to having employees, at all levels, equipped with the requisite skills sets. This is demonstrated through the Company's investment in excess of R420 million on skills development – an increase of 8% on prior year. This equates to 4,2% of our labour bill and is above the market norm for large corporates.

Our skills development and capacity building initiatives extend to all levels of the Company and include the training and development of unemployed individuals and scholars. We remain closely aligned with the Government's JIPSA programme in support of the ASGISA programme. The Company's commitment to the national skills agenda is evident in its active participation in developing the new Human Resource Development Strategy of South Africa (HRDSSA). Transnet will continue to form part of the process to integrate the HRDSSA and JIPSA initiatives.

During the year, the company assisted or sponsored the following students:

Engineering bursars	315
Technical bursars	290
Learners in TOPP programme	11
Bursars on the Thuthuka programme	30
Graduates in training	40

Public policy and economic regulation

Overview

The role of state-owned enterprises in a "developmental state" continues to be debated amongst economic policy-makers. The advent of the new political administration in May 2009 in a most challenging economic climate brings renewed policy focus to this question. Transnet engages constructively in these policy discussions, mindful of the key role it plays in ensuring that South Africa's freight transport and logistics backbone is effective and provides appropriate capacity ahead of demand. We are confident that, henceforth, greater policy and economic regulatory certainty can be provided for Transnet.

Economic regulators are required to ensure a balance between the interests of consumers and those of the regulated business. While consumers want to pay as little as possible, the business must recover its costs and make a fair return on capital employed so that long-term infrastructure investments can be made in a sustainable manner. In this context, certainty on the "rules of the game" and their consistent application is vital to enabling the Transnet Board to fulfil its fiduciary duty.

Unfortunately, the economic regulation environment within which Transnet operates is uncertain. NERSA licences the operation and construction of petroleum pipelines, amongst others, and determines the tariffs we can charge our pipeline customers. The Ports Regulator is responsible for approving the National Ports Authority's tariffs and promoting competition in ports operations. However, the rules – for both NERSA's tariff determinations and the Ports Regulator's tariff approvals – remain unclear.

Ports policy – National Ports Act of 2005

With the National Ports Act coming into effect in 2006, Transnet alerted Government to the adverse consequences of corporatising the National Ports Authority, and last June, the Government gave Transnet the assurance that this provision and other parts of the Act would be reviewed. We will engage with the DPE on this critical matter during the forthcoming year.

Ports – economic regulation

In the case of the Ports Regulator, the directives setting the regulator's approach to economic regulation had, at the time of writing this report, not been finalised. Based on the draft directives, the National Ports Authority submitted its tariff application for 2009/10 last August, but in the absence of a decision by the regulator at the start of the financial year, Transnet had no option but to proceed with inflation-adjusted tariffs. This increase, however, results in revenue that falls significantly short of what is required to sustain the port infrastructure investment that is taking place. We are hopeful that the directives, once finalised, will provide an appropriate framework for investment and that regulatory uncertainty will be minimised.

Pipelines – economic regulation

Unlike the ports environment discussed above, Pipelines have approved tariff regulations and methodology to determine the applicable tariff. However, these regulations have been inconsistently applied by NERSA to a business that has a very similar cost structure and asset base from one year to the next. This is evidenced by the tariffs approved by NERSA which are as follows:

- 2008 – 0% increase
- 2009 – 4,2% increase
- 2010 – 10,4% decrease

This inconsistency introduces significant uncertainty in relation to future revenue and has a consequent adverse impact on the ability of Transnet to obtain and plan optimal funding solutions. Further the absence of appropriate methodology that governs the determination of tariffs of assets under construction (and inconsistent application) has also adversely impacted Transnet. The application of the current methodology resulted in Pipelines' tariffs being approximately R1 billion less than was budgeted. The effect of NERSA's decision is to defer the inevitable tariff increases to when the pipeline is brought into use in the 2012 financial year. A further consequence of the decision is that tariff increases that could have been spread over the years of construction will now peak when the pipeline is brought into use. Transnet is in talks with the Government regarding an alternative funding mechanism for assets under construction.

However, the construction of the new pipeline continues as planned and will be completed and operational within the prescribed time frames. This is in keeping with our commitment to protect the security of supply of petroleum products to the inland market.

Rail

Rail economic regulation continues to be mooted by the Government, but its purpose and scope remain unclear. Given the levels of capital investment being made in Freight Rail, it is important that such regulation does not undermine these critical rail infrastructure requirements.

Letter to society

Investing in our communities

Corporate Social Investment (CSI)

During the year, we completed the restructuring of the Transnet Foundation into a dedicated specialist unit of the Company to improve the efficiency and impact of its operations. We did away with the Trust structure and Board of Trustees and, in its stead, established an Advisory Board. The executive members of the Trust stepped down and the former non-executive members of the Trust, save for one (the Rev Allan Storey who relocated to Cape Town), agreed to become founding members of the Advisory Board. As anticipated, this ensured that the expertise, wisdom and guidance of the Trustees was not lost and that the change was accompanied by continuity. Importantly, this reform ensured that the former trustees could continue their tasks of guiding the Foundation without assuming the onerous burden inherent in being trustees.

As indicated in the past, the reforms are designed to enhance, not impede, the work of the Foundation, as our premier vehicle for social investment. The Foundation continued to be the primary channel of the Company's R80 million grant to worthy causes in education, the arts, sports and in the area of primary health care.

We continue to be proud of the positive impact on the lives of hundreds of thousands of less fortunate South Africans by Transnet's Phelophepa, our miracle health train. This award-winning train, which acts as a training facility for hundreds of medical students, provides a range of medical services including dental and eye care and counselling. Each year, it reaches more than 45 000 patients who need dental, psychiatric counselling and primary health care during its 35-week journey into the most rural parts of our country.

The multi-pronged partnership, combining the efforts of communities, Transnet, Government and the private sector, is to be replicated in Phelophepa II, which is now due for commissioning in 2011.

In November 2008, we bade farewell to Dr Lilian Cingo, the founding manager of Phelophepa I, who retired. We wish her well in her retirement.

Unfortunately, work on turning around the Transnet School of Excellence, the soccer academy, is not progressing at the pace we had hoped it would. We are intensifying our efforts to make this truly a place of excellence where the school's dual mission of nurturing both academic competence and football talent can be realised. The poor academic results of the past year – the worst to date – are a serious cause for concern and reason for management intervention at the school.

On the positive side, we salute Steven Pienaar, a regular for English Premier League club Everton and a graduate of the school, who starred for his team at the coveted finals of the FA Cup – the oldest and arguably the most prestigious tournament at club level – in May 2009.

Caring for our pensioners

Transnet cares about the well-being of all its employees – past and present – and their dependants. In part, this is why we have spent the last few years restructuring, together with the trustees, the various pension funds to ensure their financial health remains strong. The restructuring of Transnet's Second Defined Benefit Pension Fund (TSDBF), which required the "immunisation" of most of the future cash flows from the vagaries of the market, has proven to be the appropriate strategy. At year-end, the two defined benefit funds – namely, the Transnet Sub-Fund of the Transport Pension Fund and the TSDBF – were both fully funded and had actuarial surpluses of R701 million and R2,8 billion, respectively. This has been achieved despite the severe downturn and significant decrease in most equity markets averaging an approximate 30%. This is a tribute to the vision of Transnet and the fund trustees in implementing the restructuring and devising an appropriate investment strategy for this type of fund.

In addition to the statutory payment of 2%, the TSDBF has paid out bonuses since 2007 and will recommend a bonus for 2009. Details of this initiative will be announced in due course.

Overview

As a concerned corporate entity, social responsibility and accountable environmental management have been priorities in our operations. Indeed, it has formed an integral part of the Company's raison d'être. Transnet has striven to provide landmark social programmes to the needy and disadvantaged in our country. It has done so in imaginative and creative ways via its CSI vehicle, the Transnet Foundation, capturing numerous awards along the way, as evident by its most recent accolade, the *Mail & Guardian's* Invest in the Future sports award. The Foundation has been quietly working behind the scenes for many years, enriching the lives of thousands throughout South Africa.

In November 2008, the Transnet Board approved a proposal to restructure the SATS post-retirement medical subsidy subject to ongoing consultations with the Transmed Board of Trustees, the Registrar of Medical Aids, SATS pensioners and other related parties. Accordingly, Transnet has provided an additional R500 million to fund the proposed restructuring.

Also, for the first time in 2008, we implemented further reforms, enhancing pensioner democracy and strengthening the independence of the TSDBF. As part of this highly participative process, elections were held for the two pensioner representatives. Therefore, in line with other leading funds, these pensioner representatives were chosen directly by fellow pensioners.

Both Transnet and the TSDBF intend to improve their communication with pensioners in the hope that this will dispel some of the negative, inaccurate and defamatory reports that have been published over the last few years. In addition, we plan to continue to enhance the position of pensioners going forward.

Prospects

The new financial year will continue to be a challenging one. Whilst it is unclear what the duration and the full scale of the recession will be, it is clear that the impact of this downturn has yet to be fully felt by industry and the commodities sectors. Anticipating continued lower volumes, we will continue to purposefully implement our Dynamic Management and Planning Framework to build in the requisite agility in our strategy to protect the health of the business during these recessionary times. We will proceed with our R80,5 billion capital investment programme as part of our strategy of preparing for growth in the future. Even during this cycle of slow growth, there are opportunities, especially where our market share remains low. Transnet will opportunistically pursue these opportunities, especially in the identified areas of domestic coal, export iron ore and containers on rail. Apart from investing in new capacity as determined by our strategic priorities, the basis of our growth lies in our multi-pronged drive to improve efficiencies and productivity across all our operations to world-class levels; a new focus on improving the Company's safety record and further progressing the implementation of appropriate environmental management standards.

Appreciation

There are many people to thank for the continued success of Transnet. They are too numerous to mention in this space; therefore, I will limit myself to acknowledging the wise counsel, unflinching support, sterling contribution and ongoing motivation of the following categories of people: my colleagues on the Board; the Executive Committee and the Extended Executive Committee; all our employees; our labour union partners in the Strategic Leadership Forum; our Shareholder; members of the Parliamentary Portfolio Committee on Public Enterprises; our investors; our bankers and financiers; our suppliers; and, of course, our loyal customers.

A few individuals deserve special mention. Included in this list are: Mr Fred Phaswana, the Chairman, for his support and guidance during the transition; Ms Maria Ramos, our former Chief Executive, for her contribution in laying the foundation of today's success and assembling a team that has so ably overseen what could have been a difficult transition; Mr Alec Erwin, the former Minister of Public Enterprises (until September 2008); Ms Brigitte Mabandla (Mr Erwin's successor in the portfolio); Public Enterprises Director-General Ms Portia Molefe for the constructive and facilitative role she has played; and Ms Fatima Chohan who supported the work of Transnet through her effective and efficient role as Chairperson of the Portfolio Committee on Public Enterprises – the committee that oversees Transnet's affairs.

We take this opportunity to welcome newly appointed political heads of the Department: namely, the Minister of Public Enterprises, Ms Barbara Hogan, and the Deputy Minister, Mr Enoch Godongwana; as well as Ms Vytjie Mentoor, the new Chairperson of the Portfolio Committee on Public Enterprises and members of that committee. We wish them well in their new responsibilities and pledge our full support and cooperation.

Finally I would like to reiterate our deepest condolences to all the families and friends of the 13 colleagues who died on duty during the financial year. We pledge to intensify our efforts to ensure that all our colleagues who come to work each day return home safely.

CF Wells

Acting Group Chief Executive

Chief Financial Officer's review

Anoj Singh
Acting Chief Financial Officer

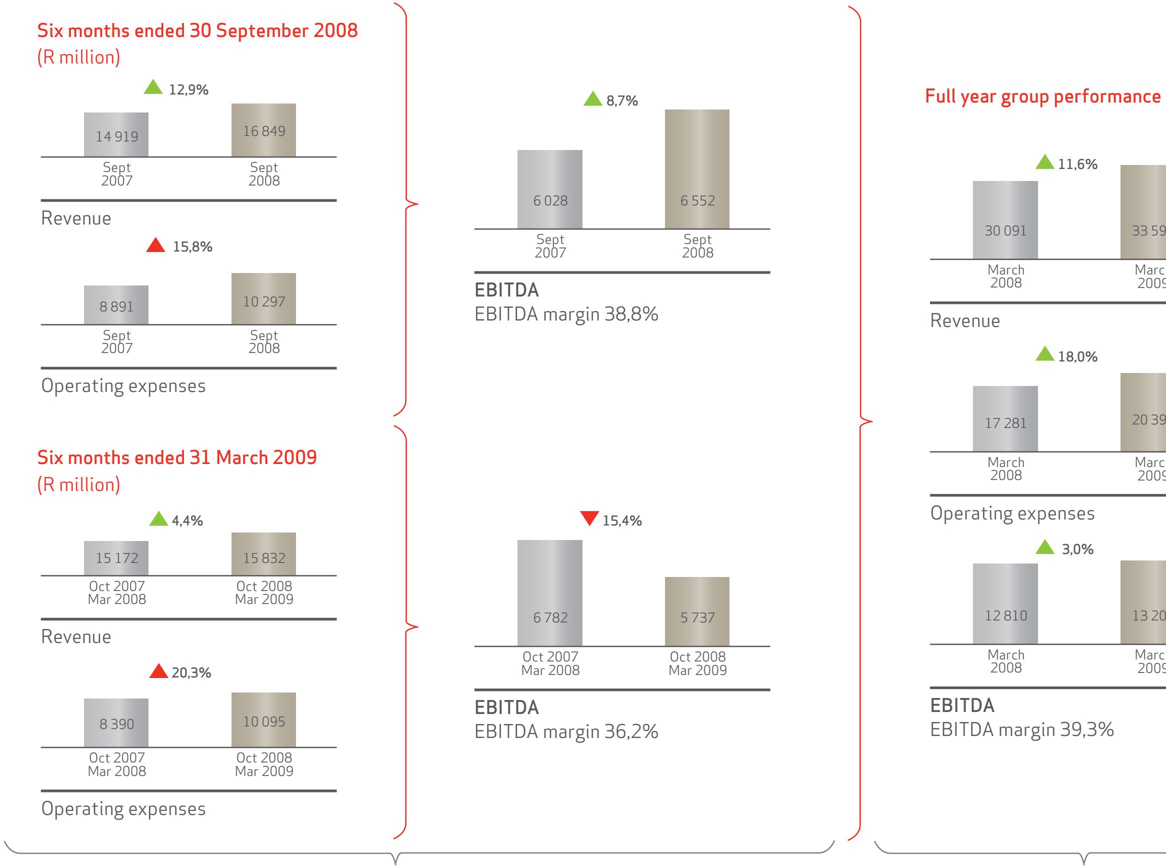
Introduction

Domestic business confidence is at a nine-year low while the outlook for the retail, manufacturing and mining sectors has become progressively weaker since the second half of 2009. This impacted on commodity and container volumes which make up a significant portion of the Group's revenue.

The graphic alongside depicts the impact of the global economic crisis on revenue, operating expenditure and EBITDA for the first six months compared to the second half of the financial year.

The first six months of the year to 30 September 2008 saw revenue increase by 12,9% when compared to the prior year, with all operating divisions reflecting volume growth with the exception of Freight Rail. Due to the global economic crisis, revenue increased by a marginal 4,4% for the second half of the year with all operating divisions showing negative volume growth – most noticeably the decrease in container and general freight volumes. Consequently, EBITDA decreased by 15,4% when compared to the second six months of the prior year.

Despite these challenges, and in the context of the global trading environment, the year ended 31 March 2009 was credible and resilient, with an EBITDA increase of 3% compared to the prior year. A strong balance sheet has been created to withstand the impacts of the global economic environment and the business has generated strong cash flows, but requires focus on working capital management. This has enabled the Company to be positioned for growth when economic conditions improve.



Group operating performance

Continuing operations

The sharp downturn in economic activity internationally and in South Africa resulted in certain commodity and container volumes handled by Transnet being below expectation, especially in the last quarter of the financial year. Nevertheless, revenue increased by 11,6% compared to the prior year impacted by the implementation of a new tariff for export coal after several years of below inflationary increases. Adjusting for the revised tariff, revenue would have increased by 8,6%.

Earnings before interest, taxation, depreciation and amortisation (EBITDA) increased marginally by 3,0% to R13,2 billion resulting in an EBITDA margin of 39,3% (2008: 42,6%). The decrease in the EBITDA margin is partly attributable to operating expenses which, whilst in line with target, increased by 18,0% to R20,4 billion. The cost increases arose from the higher cost of fuel, electricity tariff increases and higher steel prices which impacted the cost of maintenance materials.

Depreciation and amortisation of assets for the year increased by 25,8% to R4,8 billion compared to the prior year, as a result of the capital investment programme and the depreciation on the revalued port facilities and pipeline assets. This trend is expected to continue in line with the execution of the capital investment programme over the next five years. Consequently, profit from operations after depreciation and amortisation decreased by 6,6% to R8,4 billion, compared to the prior year.

Post-retirement benefit costs are actuarially assessed every six months, in accordance with IAS 19, and adjusted accordingly. The valuation at March 2009 has resulted in a favourable adjustment of R169 million. This was offset by a provision of R605 million which was created for the restructuring of the SATS post-retirement medical subsidy and other post-retirement benefits, which will be once-off contributions to these funds.

The impairment charges arose primarily from Freight Rail as a result of derailments that occurred during the year, amounting to R324 million. Safety remains a key operational challenge for Transnet and will be continually managed to achieve an improvement in safety performance.

Fair value adjustments for the year amounted to R941 million, compared to R1,4 billion in the prior year and relate mainly to the revaluation of investment property and the mark to market of derivative financial instruments.

Accordingly, net profit from operations before finance costs reflected a decrease of 21,2% when compared to the prior year.

Finance costs decreased by 17,1% to R2,2 billion mainly as a result of the capitalisation of borrowing costs in terms of IAS 23. Capitalised borrowing costs in the current year amounted to R764 million compared to R303 million in the prior year and are expected to increase in line with the capital expenditure programme over the next five years.

Finance income has declined to R267 million (2008: R761 million) as cash has been utilised to fund the capital investment programme.

The taxation charge for the year amounted to R1,7 billion, compared to R2,6 billion in the prior year, comprising a current taxation charge of R739 million (2008: R1,2 billion) and a deferred taxation charge of R1,0 billion (2008: R1,4 billion). The effective taxation rate for the Group at 24,9% (2008: 29,1%) is below the corporate taxation rate of 28% due to taxation exempt income.

Profit for the year after taxation decreased to R5,0 billion due to increased depreciation and amortisaton charges, as well as post-retirement benefit obligation costs. Accordingly, headline earnings decreased to R3,8 billion.

Discontinued operations

Businesses and investments meeting the criteria set out in IFRS 5 Non-current Assets Held-for-Sale and Discontinued Operations (IFRS 5) are reported as discontinued operations.

The loss from discontinued operations decreased from R1,9 billion in the prior year to R516 million mainly due to the impairment of the carrying values of Shosholoza Meyl and Autopax Passenger Services (Pty) Ltd to their estimated selling price as required by IFRS 5 in the prior year. As part of the disposal of non-core assets, Shosholoza Meyl, South African Express Airways (Pty) Ltd and Autopax Passenger Services (Pty) Ltd were disposed of during the year.

Group financial position

Revaluation of property, plant and equipment

During the year, the Group conducted a revaluation of its pipeline networks in line with the accounting policy, which requires an independent valuation every three years with an index valuation in the intervening periods. Consequently, an amount of R636 million was recorded as an adjustment to the carrying value of the pipeline networks.

In addition, the carrying value of port infrastructure and port operating assets was revalued by R3,5 billion after the application of appropriate indices.

The operating assets of the Group have increased from R47,6 billion in 2006 to the current R102,5 billion, due to the capital expenditure programme, revaluation of assets, and investment property adjustments, thereby reflecting Transnet's significant infrastructure investment to enable future economic growth.

Deferred taxation

The deferred taxation liability increased from R6,7 billion to R8,6 billion, resulting from an income statement charge of R1,0 billion as well as deferred taxation arising from revaluations being recorded directly in equity.

Cash flows

Cash generated from operations increased marginally to R13,5 billion. The working capital requirements of the Group were negatively impacted by R1,4 billion due to the accrual of the coal line tariff as well as the recording of PRASA as a debtor for the sale of Shosholoza Meyl.

Capital expenditure for the year amounted to R19,4 billion compared to R15,8 billion in the previous year – an increase of 22,8%.

Cash interest cover at 4,0 times remains strong, whilst the target is to remain above 3,0 times throughout the capital investment programme over the next five years.

Borrowings

The world financial crisis led to increased liquidity and solvency risks in global financial markets. Interest rate spreads in the debt capital markets increased and funding became focused on the short term. The domestic market was also impacted with Government yields and coupon spreads widening. These factors led to long-term borrowings becoming more difficult to source and more expensive. Nevertheless, Transnet raised a net R11,6 billion mainly through the issuance of bonds, after the redemption of the T004 bonds amounting to R3,2 billion.

Transnet also concluded bilateral loans worth R6,0 billion with eight local and international financial institutions during the year with an additional R1,0 billion raised subsequent to year-end. These loans have tenors of between three and five years, and will be used in funding the Company's capital investment programme. The Japan Bank for International Cooperation (JBIC) provided a ¥35 billion untied funding facility to Transnet at a very competitive cost of debt. This loan will be used to finance the widening and deepening of the Durban harbour entrance channel.

The Group also successfully concluded a transaction with Finnvera, the Finnish export credit agency, amounting to R915 million. Both of these transactions demonstrate international investor confidence in Transnet.

Transnet's short-term funding needs are financed through the issuance of commercial paper under the R30-billion Domestic Medium-Term Note Programme and R6 billion commercial paper was in issue at year-end.

The gearing ratio increased to 36% (2008: 30%), as a result of the R19,4 billion capital expenditure incurred, which is below the Company's target ceiling of 50%. These gearing levels provide the Group with significant borrowing capacity to raise the required funding to ensure the successful rollout of the capital investment plan. It is projected that gearing will not exceed 47% over the medium term.

The planned capital expenditure of R80,5 billion over the next five years will require the Company to raise approximately R32,9 billion from the debt capital markets in the medium term. A robust funding strategy is in place to fund this requirement with the objective of achieving a competitive cost of funding and diversification of the funding portfolio to include both local and foreign borrowings.

The Company has adequate cash on hand of R5,9 billion and banking facilities to meet its commitments. At the end of the year, Transnet had unused borrowing facilities of R34,7 billion, of which R3,5 billion is available immediately to fund working capital.

Contingencies and commitments

There have been no material movements in contingencies and commitments since 31 March 2008.

Guarantees

The sole Shareholder in Transnet Ltd, namely the South African Government, has guaranteed certain borrowings of the Group to the extent of R11,7 billion, compared to R19 billion in the previous year.

Pension and post-retirement benefit obligations

The Group provides various post-retirement benefits to its active and retired employees, including pension, post-retirement medical and other benefits. The two defined benefit funds, namely, the Transnet Sub-Fund of the Transport Pension Fund (TPF) and Transnet Second Defined Benefit Fund (TSDBF), are fully funded with actuarial surpluses of R701 million and R2,8 billion, respectively. Transnet has not recognised any portion of the surplus on these funds as the fund rules at present do not allow for the distribution of a surplus. The post-retirement benefit obligation for the medical funds has increased by R57 million to approximately R1,9 billion.

In November 2008, the Transnet Board approved a proposal to restructure the SATS post-retirement medical subsidy, subject to ongoing consultations with the Transmed Board of Trustees, the Registrar of Medical Aids, SATS pensioners and other related parties. Accordingly, Transnet has provided an additional R500 million to fund the proposed restructure.

Capital expenditure

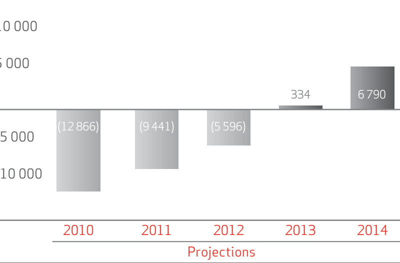
Of the R19,4 billion capital investment in the current year, R8,5 billion was spent to maintain current infrastructure and equipment and R10,9 billion spent on expanding capacity.

Over the past four years, the Group has spent and successfully implemented capital projects to the value of R53,5 billion, which is cumulatively more than the expenditure in the past 15 years. Transnet remains committed to its five-year capital investment programme amounting to R80,5 billion. This relates mainly to the upgrade and expansion

Chief Financial Officer's review (continued)

Funding of the Capital Investment Plan

Capital investment for the next five years is estimated at R80,5 billion with R57,7 billion being spent in the first three years (2010 to 2012). Based on the estimated gross capital expenditure, as well as cash from operations and loan redemptions, the graph below reflects the estimated cash shortfall and surplus over the five years. These cash shortfalls or deficits will have to be funded via the debt capital markets.



Net cash (shortfall)/surplus (R million)

of rail infrastructure, port facilities and pipeline networks. Transnet is committed to both sustaining the current infrastructure and to expanding the business with the aim of providing capacity ahead of demand. Approximately 48% of the investment plan will be spent on creating additional capacity over the five-year period.

The Group will, however, continuously review the investment programme in the context of the global economic downturn and its impact on the local economy and volume and capacity requirements of all major customers over the next five years.

Funding strategy

Transnet will focus on diversifying funding sources both in the domestic and international markets to ensure that it is able to raise the necessary funding cost-effectively. The following sources of funding are potentially available to Transnet, subject to economic conditions and the cost of funding:

- Commercial paper for short-term funding
- Domestic capital markets for bond issuances, specifically for:
  - new bonds in the domestic capital markets; and
  - re-tapping the existing TN17, TN23 and TN27 bonds and new bonds through regular (two-weekly) auctions to build liquidity.
- ECA-supported or commercial asset backed funding
- Private placements in foreign markets
- Foreign issuance in USD, euro or yen markets
- Development finance institutions
- Project finance
- Public private partnerships (PPPs)
- Bank loans

The table below reflects the risks to the funding strategy and possible mitigating strategies to minimise these risks in line with the Financial Risk Management Framework (FRMF).

Risks and mitigating strategies	
Cash flow estimates being significantly different from actuals	• Implementing a regular cash flow forecasting process. • Capital Investment Committee regularly reviews the Capital Investment Plan.
Liquidity crunch in the market and insufficient investor appetite	• Continuing to establish and utilise both local and offshore borrowing programmes to diversify sources of funding. • Utilising committed short-term bank loans. • Utilising a commercial paper programme.
Delays in capital project implementation	• Reviewing major projects' forecasts monthly in line with the cash management policy. • Working closely with project teams from initiation of key projects.
Exchange rate movements	• Encouraging rand contracting. • Hedging currency exposure at agreement signing stage. • Utilising the SA Reserve Bank approved Customer Foreign Currency account to create natural hedges. • Monitoring currency movements on a quarterly basis and assessing the impact on projects and where possible, capping certain costs.
Commodity price movements	• Monitoring commodity price movements on a monthly basis and, where appropriate, capping the price or hedging exposures.
Rising interest rates	• Monitoring interest rate movements and, where appropriate, using derivative instruments to hedge imminent exposure. • Balancing the fixed/floating mix of loans to create natural hedging.

Financial risk management

The Group's policy, as contained in the FRMF, with respect to the hedging of foreign currency exposures and the management of financial risks was approved by the Board, and will continue to be enhanced to ensure risks are identified and managed in a structured and controlled manner through the Group Finance Committee (FINCO). Transnet, like most companies, is faced with financial risks that need to be carefully managed to ensure that the impact on the Group's financial performance and position is minimised against these market movements.

The major risks and mitigating strategies are summarised below and should be read in conjunction with Annexure A to the annual financial statements:

Risks	Implications	Mitigating actions
Interest rate risk	• Potential impact on profitability and the ability to service debt and to complete the capital programme • For a sensitivity analysis of this risk on the Group refer to Annexure A	• Debt restructuring and monitoring • Continuous market monitoring • Hedge against the risk using derivative instruments • Board approved fixed rate debt ratio
Exchange rate risk	• Impact on funding, profitability and capital programme • For a sensitivity analysis of this risk on the Group refer to Annexure A	• Contract in rand as far as possible (supplier to hedge) • Hedge at project initiation and hedge account cash flows • Natural hedge-fund currency contract with same currency • Utilise rand ECA** guaranteed funding
Commodity price fluctuations	• Implication on profitability and costing of capital projects • For a sensitivity analysis of this risk on the Group refer to Annexure A	• Dynamic management reporting programme and forward planning on cost reduction • Identification of possible additional revenue streams to supplement decreasing volumes (mainly export commodities) • Maintaining energy levy contracting (85% of GFB already done) • Hedge fuel consumption not covered by levies • Strategic sourcing initiatives
Funding risk relating to: • Liquidity • Credit rating downgrade • Working capital management	• Inability to raise funds and to meet capital and operational requirements • The funding requirements of the Group are outlined on page 28	• Implement and enforce cash management policy, especially three month forecasting • Diversify sources of funding and investor base by creating multiple facilities in different markets • R4 billion committed bank facilities accessible within 24 hours established • Robust credit risk monitoring and management • Test Capital Plan against key ratios and limit to targets (gearing and interest cover) • A loan redemption in excess of R2 billion must be prefunded six weeks
Managed via Board approved financial risk management framework Compliance maintained via Treasury/Transnet internal audit (TIA) and reported to FINCO/EXCO*		
Investment risk specific to: • Return on investment • Asset turnover	• Inappropriate return on investment • Additional risks and mitigating actions are detailed on page 110	• Sign take or pay customer contracts which guarantee revenue even though volumes might be uncertain. • Capital rationalisation initiative (reassessment of projects underway to take into account the effect of the global downturn) • External project management costs are regularly monitored • Implementation of enhanced capital expenditure budgeting and monitoring system • Project and procurement manager competency development on contract lifecycle management
Managed via divisional and group Capital Investment Committee with approved mandates* Reporting to EXCO and Board*		
Overall breakdown of controls resulting in: • Inaccurate financial and management reporting • Increase in fraud	• Fraudulent activity not prevented or detected • Management decisions based on incorrect information • Reporting and regulatory requirements not being met	• Monthly CFRC** monitoring and signoff by financial managers and OD CFOs** • Active management of CSA** process • Process and control manuals being created and rolled out to all ODs • Regular analysis of management reports and follow up on variances • Continuous Control Monitoring being introduced • Frequent publications around forensic investigation and marketing of Tip-Offs Anonymous Hotline • Major "Tip-Offs" are investigated by TIA • Annual Fraud Risk Management Plans are created and progress against plans are being monitored • Segregation of key duties and enforce delegations
Managed via TIA/GICC/OD ICSC/OD FWG** and OD Sub-audit Committee all with approved mandates* Reporting to FINCO/EXCO and Group ACM*		
Economic regulation	• Greater uncertainty regarding future cash flows • Impacts funding of capital projects • NERSA approved a tariff decrease for Pipelines for the 2010 financial year of 10,4% amounting to R1 billion	• Engage with regulators to ensure methodology for tariff determination supports an appropriate return on invested capital • Engage with Government on alternative funding methodology with respect to assets under construction
Managed via PPRC** with an approved mandate* Reporting to EXCO and Board*		

* *For details regarding mandates and committees, refer to page 66.*
** *Refer to abbreviations and acronyms on page 286.*

Restatements

IAS 12: Income Taxes

In the prior year, management estimated the split between taxation depreciable assets and non-taxation depreciable assets in respect of pipeline assets to calculate the deferred taxation liability. This split was reviewed in the current financial year, which resulted in a decrease in the proportion of taxation depreciable assets to non-taxation depreciable assets. Accordingly, an adjustment was required in the prior year. In addition, deferred taxation was duplicated on a finance arrangement in the prior year and has subsequently been corrected.

IAS 23: Borrowing Costs

All borrowing costs incurred on qualifying assets are capitalised to the cost of property, plant and equipment. However, in the prior year, this was not consistently applied across all qualifying assets and this has resulted in a reduction in finance costs of R16 million.

IAS 21: The Effects of Changes in Foreign Exchange Rates

An assessment of forex gains and losses on derivative financial instruments resulted in a restatement of fair value gains. The financial effect of this restatement has resulted in a reduction in fair value gains by R64 million before tax in the 2008 financial year.

IAS 19: Employee Benefits

An assessment of the manner in which transfers from the funds were treated resulted in a reduction of the actuarial gains and losses in the prior year of R151 million before taxation.

IAS 16: Property, Plant and Equipment

In terms of an approved incentive bonus scheme, certain contractors who are engaged to construct assets were entitled to an incentive payment. This payment in terms of IAS 16 should have been recognised as part of the carrying value of the asset but was incorrectly expensed. Consequently, an adjustment of R50 million was recorded.

IAS 37: Provisions, Contingent Liabilities and Contingent Assets

The Group has had a legal obligation as defined in terms of IAS 37 for the rehabilitation of land contaminated by asbestos since the enactment of certain legislation in 1998. Accordingly, a provision has been recorded for the estimated costs of the restoration. This has resulted in the recognition of a provision of R700 million and an increase in the depreciation charge of R3 million recorded against opening reserves.

Enterprise-wide performance management (EPM)

Integrated performance metrics

During the year, the Shareholder Value Add (SVA) framework was developed as an integrated performance metric and linked to the value drivers across the Group. SVA therefore integrates financial and operational performance indicators from each division into a single value driver model for the Group and is used as a basis for determining the key performance indicators for monitoring and reporting. This enables management to focus on the most important value drivers during performance dialogues to ensure the Group's strategic objectives are achieved.

Dynamic Management and Planning Framework

The Company has developed a Dynamic Management and Planning Framework (DMPF) in response to the changes in the macro-economic environment during the year. This framework analyses the key cash drivers of the Company and assesses the impact of these drivers on the financial performance and key financial metrics of the Company on a weekly basis. The DMPF allows the Company to respond to changes in the business landscape timeously and effectively.

Management developed numerous scenarios to assess the impact of declining volumes on the key revenue drivers of the business. These scenarios are based on a 95% (Level 1), 90% (Level 2), and 80% (Level 3) probability of revenue achievement which will have a consequent impact on profitability, cash flows and key financial ratios such as gearing and cash interest cover as depicted in the graphic below. It is imperative for Transnet to retain its financial strength by maintaining a cash interest cover of at least 3,0 times in the medium term and gearing of below 50%.

Impact of declining volumes on 2010 targets

Volumes	Impact	Cash interest cover (times)	EBITDA R billion	Gearing %
Target – 100%		3,6	12,3	43,1
Level 1 – 95%		3,2	11,0	44,0
Level 2 – 90%		2,8	9,7	44,9
Level 3 – 80%		2,1	7,1	46,7

To mitigate these challenges, the Group has considered a number of action plans which include:

- Increasing external revenues in the year ahead by focusing on product flows where there are opportunities for Transnet to retain and expand its market share.
- Further reducing operating costs in 2010 through improved operational efficiencies, reduced procurement costs and cost savings in all other areas in the Group.
- Optimising capital expenditure for 2010 to ensure that Transnet remains within the set financial parameters. This reduction will be mainly achieved through savings in project costs and the reduction in the number of smaller projects.
- Focusing working capital and cash management on inventory turnover, effective management of accounts payables and cash management on a weekly basis.

The current assessment of the possible impact on the Company is a Level 1 impact. The necessary action plans have already been put in place to mitigate this risk.

Internal control environment

Internal Audit

Internal Audit activities are in line with the requirements of the PFMA and leading practice. The activities of the function will develop in accordance with the maturity of the overall internal control framework. Having successfully stabilised the financial control environment, Internal Audit's focus will now shift toward operational controls with the objective of enhancing organisational performance through controls.

Business processes and controls

The Company has developed initiatives to improve the identification, operation, documentation and enhancement of controls for operational and financial processes across operating divisions.

In 2008, significant improvements were achieved in streamlining financial processes and enhancing the overall control environment. Critical financial reporting controls (CFRCs) were identified and prioritised for improvement. The objective of these controls is to ensure that material misstatement of reported results is prevented. The effectiveness of these CFRCs significantly improved from the first to the last quarter of the financial year. Given the successes of the CFRC implementation, the Group intends to expand this concept into the operational areas of the business with the definition of Business Critical Controls (BCCs).

Monitoring activity

It is critical for management to play a leading role in internal control monitoring. Consequently, various initiatives are ongoing to improve this area of monitoring. These include the use of key performance indicators and control self-assessment, both of which have been introduced widely across the Group. Continuous control monitoring will be introduced during the next financial year which will further empower management to monitor controls on an ongoing basis.

Shareholder's Compact

Performance criteria

In pursuance of its objective to promote good corporate governance in state-owned enterprises, the Government, as Transnet's sole Shareholder, and Transnet have signed a Shareholder performance agreement (Shareholder's Compact).

Key Performance Indicators and other criteria for the year ended 31 March 2009 as well as targets for the year ahead, as required by section 55(2)(a) of the PFMA, have been outlined in the report of the Directors (refer page 182).

Group accounting policies

The financial statements have been prepared using accounting policies that comply with International Financial Reporting Standards. The accounting policies are consistent with those applied in the financial statements for the year ended 31 March 2008, except for the following changes:

During the year, the Group early adopted IFRS 8 Operating Segments (IFRS 8). IFRS 8 replaces IAS 14 Segment Reporting (IAS 14). The core principle of IFRS 8 is that an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. A restatement of comparatives has been performed in line with the requirements of the standard. IFRS 8 is a disclosure standard and consequently has not impacted reported results.

Furthermore, interpretations issued by the International Financial Reporting Interpretations Committee are applicable to the Group for the current period. The only interpretation impacting the Group is IFRIC 14: IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (IFRIC 14). The adoption of this interpretation has had an insignificant impact on the Group's results.

Prospects

The marked decline in economic activity in South Africa has negatively impacted volumes handled by Transnet, and these conditions seem likely to persist for the next financial year. Nevertheless, implemented actions to reduce costs, improve efficiencies and harness certain volume opportunities will mitigate this risk and ensure that all financial metrics are maintained within targeted levels. This will enable the Group to execute its strategy.

Anoj Singh

Acting Chief Financial Officer

Post-balance sheet events

The following significant issues have occurred between 31 March 2009 and 18 June 2009:

Sale of Autopax Passenger Services (Pty) Ltd

Autopax Passenger Services (Pty) Ltd was sold to PRASA for R1 effective 31 March 2009, as this was the date on which risks and reward of ownership passed. The Sale of Shares agreement was signed on 1 April 2009.

The sale of this business was recorded at 31 March 2009.

Sale of Shosholoza Meyl

The long distance commuter passenger service, known as Shosholoza Meyl, was sold to PRASA for R100 effective 31 March 2009, as this was the date on which risks and reward of ownership passed. A Sale of Business agreement was signed on 7 May 2009. As part of the transaction, PRASA paid an amount of R500 million to Transnet on 22 May 2009. This amount related to the reimbursement for operating expenditure incurred by Transnet prior to transfer date.

The sale of this business was recorded at 31 March 2009.

Pipelines tariff application

Pipelines tariff application for the 2010 financial year was rejected by NERSA. Instead, NERSA decreased tariffs by 10,4%. This decrease is of a temporary nature due to the methodology used by the Regulator in the determination of tariffs by excluding assets under construction in the regulatory asset base (RAB) until they are brought into use, which is expected to occur progressively until 2012 – the project completion date. In the interim, Transnet is in discussion with Government regarding an appropriate funding model for assets under construction.

Consolidated value added statement

As at 31 March 2009

Value added is defined as the value created by the activities of a business and its employees. For Transnet, this is determined as revenue less the cost of materials and services. The value added statement reports on the calculation of the value added and its application among the stakeholders of Transnet.

	2009 R million	%	Restated 2008 R million	%
Revenue	**33 592**		30 091	
Cost of materials and services	**(10 986)**		(8 759)	
Net operating expenses excluding depreciation, derecognition and amortisation	**(20 392)**		(17 281)	
Excluding: Personnel costs	**9 406**		8 522	
Value added by operations	**22 606**	**95**	21 332	90
Other income	**1 290**	**5**	2 240	10
- Investment and other income	**267**		761	
- Income/(loss) from associates	**82**		(59)	
- Dividend income	**–**		122	
- Fair value adjustments	**941**		1 416	
Value added/created	**23 896**	**100**	23 572	100
Applied as follows:				
Employees	**9 842**	**41**	7 836	33
- Personnel costs	**9 406**		8 522	
- Post-retirement benefit obligation costs/(income)	**436**		(686)	
Providers of capital	**2 233**	**9**	2 692	12
- Lending institutions	**2 233**		2 692	
Government	**761**	**3**	1 242	5
- South African normal taxation	**739**		1 237	
- Capital gains taxation (CGT)	**15**		–	
- Foreign taxation	**7**		5	
Re-invested to maintain and expand operations	**11 060**	**47**	11 802	50
- Depreciation, amortisation and impairment	**5 103**		3 951	
- Deferred taxation	**913**		1 400	
- Net profit	**5 044**		6 451	
Value apportioned	**23 896**	**100**	23 572	100