Media statement

Transnet reports solid results in year ending 31 March 2019

Performance highlights

• Revenue increased by 1,6% to R74,1 billion.
• Operating costs contained to R40,3 billion (no increase on prior year).
• EBITDA increased by 3,8% to R33,8 billion.
• Profit for the year increased by 24,7% to R6,0 billion.
• Capital investment of R17,9 billion for the year, bringing total expenditure over the past seven years to R183,5 billion.
• Cash generated from operations increased by 0,7% to R35,2 billion.
• Gearing of 44,5% and cash interest cover at 2,9 times.
• The Company recorded a disabling injury frequency rate (DIFR) of 0,71 – below 0,75 for the eighth consecutive year and well below the global benchmark of 1,0.

Governance and compliance

Supporting National Government’s developmental mandate

Transnet SOC Ltd is a significant entity in the lives of all South Africans; and as one of the largest logistics infrastructure SOCs on the African continent, it is in many ways the very heart and lungs of our economy. This 55 000-strong employee community is also a microcosm of the macrocosm that is the South African developmental state. As such, it is both our duty and privilege to support National Government’s developmental mandate through large-scale industrialisation, active and competitive supplier development (SD), job creation and employment equity – both within Transnet’s operations, and through the creation of direct and indirect industrialisation opportunities in the wider economy. We achieve this developmental mandate, in great part, through our sector partnerships and Transnet’s SD programme, which promotes industrialisation through contractually obligated SD plans. During the year, Transnet’s SD spend amounted to R5,7 billion, or 17,66% of TMPS1.

In contravention of the PFMA

By all accounts, Transnet was not immune to the now widely publicised scourge of ‘state capture’, which manifested as a systemic weakening of South Africa’s SOCs over the past nine years – by both organs of State and private sector companies – through the misallocation of resources, widespread corruption, weakened leadership structures and the breakdown in governance control systems. However, several ongoing investigations into the breakdown of Transnet’s own internal controls, particularly within the procurement environment, have revealed that, irregular expenditure can result from a myriad of factors, including procedural and policy misalignment; subjective and inaccurate policy interpretations by supply-chain officials; a lack of financial, business or supply-chain acumen; and poor procedural discipline. In as much as Transnet must continue to investigate past instances of PFMA violations relating to contracts entered into in prior years, it is critical that the causes of irregular expenditure are clearly understood and mitigated at source and that consequence management is appropriate to the actual causes of such events.

In the prior year, the audit opinion was qualified due to external audit being unable to obtain sufficient audit evidence that the disclosure of irregular expenditure was complete and accurate. Accordingly, management made a concerted effort to improve internal controls during the reporting year, which included the ongoing investigation and identification of PFMA contraventions in previous years. Management’s efforts further encompassed the methodical improvement of the recording and reporting of irregular expenditure – both to accurately identify and disclose

1 Total measured procurement spend (TMPS),
instances of irregular expenditure, and to limit new incidents of non-compliance. The progressive success of these efforts is evidenced in part, by the fact that the vast majority of the irregular expenditure reported in the current year relates to expenditure in prior years arising from contracts entered into in previous years. The amount of irregular expenditure reported in the current year is significant due to the expected inclusion of R41.5 billion expenditure on locomotive contracts concluded prior to 2015.

Further, to enhance the Company’s ability to identify and remediate new instances of irregular expenditure, the Transnet Board, together with the Department of Public Enterprises (DPE), appointed the Auditor-General of South Africa (AGSA) to provide additional oversight, in relation to PFMA compliance, during the 2019 external audit process, thereby bringing the AGSA’s extensive supply-chain management expertise to bear in the interpretation of new audit findings in the procurement space.

2019 qualified opinion
Despite the above corrective actions, the external auditors have expressed the view, that Transnet’s application of certain of the Preferential Procurement Regulations, 2017 relating to tender pre-qualification criteria was inconsistent with the legislation. Although the Company ceased using the tender pre-qualification criteria in June 2018, management did not consider the affected expenditure as constituting irregular expenditure as denoted in the audit finding, as the use of the tender pre-qualification criteria aimed to assist the Company to achieve the competitive supplier development targets set by the shareholder. This matter has since been considered in detail and, after input from various technical and legal experts it appears that there are divergent views on whether expenditure arising from tenders containing the pre-qualification criteria, should indeed be interpreted as irregular, as defined by the PFMA. This matter is still under investigation.

Ultimately, however, the Company was not in a position to satisfy external audit that the reporting of this category of irregular expenditure is complete and accurate and, accordingly, the external auditors have issued a qualified opinion that is specific to the completeness and accuracy of the reported irregular expenditure, as required by the PFMA.

Going concern status
By way of clarification, the qualified opinion does not relate to compliance with International Financial Reporting Standards (IFRS) nor the Companies Act of South Africa, 2008. Accordingly, the qualified opinion has no bearing on the financial strength and sustainability of the Company, as adequately demonstrated by Transnet’s financial performance in the Financial Statements. The Company holds the view that the qualified opinion will, therefore, not result in any negative action related to the debt book; and is satisfied with the adoption of the going concern assumption in the preparation of the Financial Statements.

Revenue and volume performance
Notwithstanding the above-stated audit qualification, Transnet SOC Limited has produced a solid set of results despite challenging economic conditions that led to lower demand in mining commodities. This, together with operational challenges, impacted on the overall volume performance for the year ending March 2019.

The Company experienced a decline in export coal volumes, minerals, cement and lime brought about by a combination of factors, including lower demand, community unrest, incidents of sabotage and operational challenges.

Notwithstanding these challenges, Transnet reported a marginal increase in revenue to R74.1 billion. The revenue increase was supported by a 9.1% increase in petroleum volumes as the inland multi product terminal reached full operationalisation. Revenue in the pipeline division increased by 17.2%, from R4.5 billion to R5.3 billion.

Rail operations experienced a 0.3% decline in revenue to R43.6 billion due to a 4.9% decline in volumes.

Transnet Engineering reported revenue of R10.5 billion, down from R11.3 billion in the prior year, due to lower external sales.

Revenue in the port terminal business increased by 5.6% to R13.1 billion, despite lower-than-expected container volumes.

Transnet’s operating costs decreased by 0.1% to R40.3 billion despite increases of 16.6% in fuel costs, representing a R6.8 billion saving against planned costs.

Funding perspective
As at 31 March 2019, the Company’s total borrowings amounted to R127.7 billion (2018: R122.6 billion), an increase of R4.9 billion compared to the prior year, primarily due to foreign exchange rate movements. The increase in the value of borrowings is offset by a corresponding increase in net derivative financial assets, as exposure to foreign exchange movements is fully hedged.

Transnet raised R6.2 billion in long-term funding for the period and is presently in advanced discussions for a further R13.3 billion, that will satisfy funding requirements through to the end of the 2020 financial year. None of this funding is supported by Government guarantees.
Capital investment
Infrastructure investment highlights for the period include:
• R3,1 billion invested in rail infrastructure.
• R4,9 billion invested to maintain the condition of rolling stock.
• R527 million invested in wagon fleet renewal and modernisations.
• R2,0 billion invested in the maintenance and acquisition of cranes, tipplers, tugs, straddle carriers and other port equipment.

At 31 March 2019, the Company had accepted 525 new locomotives into operations as part of the 1 064 locomotive contract. Expenditure of R33,6 billion has been incurred to date on the 1 064 locomotive contract, with R3,9 billion invested in the current year.

Stabilising operations
At the time of publishing this statement, the employment contracts of a number of former Transnet executives have been terminated through dismissal or resignation, and others are on suspension facing disciplinary proceedings. As a result, the Transnet executive and extended executive leadership structures presently include several interim appointments, some of whom have been with Transnet for more than two decades. As such, they bring institutional knowledge and organisational experience, as well as fresh perspectives and objectivity to the business. The process for recruiting permanent executive members is actively underway.

Engaging customers
To ensure Transnet better understands the commercial needs of our customers, the Company hosted numerous integrated customer and industry engagements during the year. The engagements included customer steering committees and customer breakfasts; and specific forums, such as the NAAMSA Automotive Industry Supply Chain Forum and the Container Liner Operators Forum. Constructive outcomes of the proactive engagements included concluding long-term take-or-pay contracts with eight manganese clients, as well as signing an internal Transnet Customer Charter (in September 2018) to drive a customer-centric culture in the Company.

Re-building trust
Transnet is a significant entity in the lives of South Africans and the local business community. Notwithstanding the adverse findings and reports at the Zondo Commission and in the media, the Board and management are confident that the vast majority of the organisation’s strong Transnet community are good, committed and passionate people who have given of themselves for the benefit of the organisation and all that it stands for.

Community engagement
Transnet committed R151 million towards its Corporate Social Investments programmes across the country. The Phelophepa “Train of Hope” continues to provide high-end primary health care services to communities situated along Transnet’s business operations. Approximately 91 548 patients benefitted from the on-board clinics on the train, while the Company’s outreach initiatives reached 315 319 people through services such as health screening, education and counselling workshops.

Industrialisation
Transnet’s total recognised broad-based black economic empowerment (B-BBEE) spend for the year amounted to 92,62% of the total measured procurement spend of R32,31 billion. R13,61 billion was spent on black-owned enterprises, with overall supplier development spend of R5,7 billion.

Safety performance
Notwithstanding Transnet achieving a DIFR of 0,71, well below the global benchmark of 1,0, four employees passed away in Transnet’s operations during the year. The Board and management review the nature and causality of all fatalities to entrench group-wide safety awareness within the organisation.

Regrettably, 134 members of the public lost their lives in and around Transnet’s operational activities during the year. Railway crossings continue to be a safety challenge. Transnet’s rail network spans some 30 400 km and, due to its large footprint, is prone to encroachment by informal settlements. The Company is, however, unequivocally committed to doing more to raise safety awareness within communities that border its rail operations.

The Transnet Board of Directors and management convey their deepest condolences to the families, friends and colleagues of the employees and members of the public who lost their lives.

Issued on behalf of Mohammed Mahomedy, Acting Group Chief Executive at Transnet SOC Ltd

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About Transnet
Transnet is wholly owned by the Government of the Republic of South Africa. The company is uniquely positioned to provide integrated, seamless transport solutions for its customers in the bulk and manufacturing sectors. This is part of its drive to improve the efficiency and competitiveness of the South African economy.

Transnet has five operating divisions:

**Transnet Freight Rail**

Overall volumes within the freight rail division declined by 4.9% from 226.3 million tons in 2018 to 215.1 million tons in the current reporting period. The division saw its revenue decrease by 0.3% to R43.6 billion.

The General Freight Business recorded a disappointing 6.7% decline in volumes to 84.7 million tons as a result of the weak economic climate locally and globally as well as various operational issues including network and resource challenges.

Improved volumes were experienced in manganese, which set a new record, and increased by 2.2% to 14.0 million tons, chrome volumes rose by 6.0% to 7.1 million tons with timber, paper and publishing increasing volumes by 4.3% to 2.4 million tons.

Export coal rail volumes fell by 6.5% to 72.0 million tons from 77.0 million tons last year due operational challenges, derailments, community unrest, train cancellations as well as general low demand in the first quarter.

Volumes on the export iron ore line decreased marginally by 0.2% to 58.4 million tons as a result of the Saldanha bridge incident that resulted in a 1.7 million tons loss in the reporting period.

Contract progress to date is as follows:

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<th>OEM</th>
<th>Name of the locomotives</th>
<th>Number of locomotives ordered</th>
<th>Number of locomotives accepted</th>
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<td>General Electric Class</td>
<td>44D locomotives</td>
<td>233</td>
<td>233</td>
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<tr>
<td>China North Rail</td>
<td>45D locomotives</td>
<td>232</td>
<td>21</td>
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<tr>
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<td>23E locomotives</td>
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<td>China South Rail</td>
<td>22E locomotives</td>
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<td>234</td>
</tr>
</tbody>
</table>

**Specialist units**

Transnet Group Capital manages Transnet’s largest capital projects.

Transnet Foundation is responsible for executing our corporate social investment initiatives.

Transnet Property manages the Company’s property portfolio.

**Transnet Engineering**

The company’s engineering division reported a decline in revenue to R10.5 billion from R11.3 billion mainly due to decreased Africa sales emanating from tough competition and unfavourable macro-economic conditions.

**National Ports Authority and Port Terminals**

Transnet National Ports Authority recorded a 6.4% increase in revenue to R12.5 billion mainly attributable to the increase in tariffs and the discontinuation of clawback accounting which was partially offset by a decrease in volumes.

Container volume performance fell by 2.8% to 4.5 million TEUs (Twenty-Foot Equivalent Unit) as a result of the subdued economy and certain operational and weather-related challenges.

Bulk and break volumes contracted by 0.8% to 82.4 million tons largely due to constraints in supply-chain logistics and lower demand for mineral bulk commodities such as magnetite and coal.

**Transnet Pipelines**

The pipeline business managed to increase volumes by 9.1% resulting in the revenue increase of R5.3 billion, from R4.5 billion in the previous period.