



“We have set what we believe to be an ambitious but entirely achievable goal of restoring Transnet, and its previously sound reputation, to its position as an integral asset of the people of South Africa.”

Mr Popo Molefe
(Chairperson)

Chairperson's foreword

The current Board of Directors (Board) of Transnet SOC Ltd was appointed on 24 May 2018, approximately two months after the end of the year under review. Its appointment coincided with the new epoch defined by the President of the Republic of South Africa as the “New Dawn”.

The New Dawn is characterised by a resolute determination to rid public institutions of all malfeasance, which set in over the past nine years of our democracy, accompanied by their systemic destruction or weakening. Our task now is to rebuild our public institutions, restore the loss of their integrity and to refocus them on their mandates. For the Board of Transnet, the strategic challenge flowing from the foregoing vision relates directly to the biggest logistics, transport and infrastructure company of the State of which the strategic mandate is to drive socio-economic development. The outcomes of its successful discharge of this task must be the stimulation of economic growth, growth of other businesses, especially small and medium-sized ones, increased jobs and the reduction of poverty and inequalities.

The Board considers itself privileged to have been appointed to the stewardship of the largest logistics, transport and infrastructure company of the people of South Africa. The Directors, without exception, appreciate the depth of dedication required of them, together with the management collective and the more than 50 000 Transnet employees. We also acknowledge the concomitant collaboration with our customers and service providers that is necessary to drive the economic growth and sustainable development of Transnet's human capital, and that of society at large.

Our first days in office coincided with sustained negative media coverage of the Company's business dealings. At the same time, the preparation of Transnet's 2018 Integrated Report and Financial Statements were near completion. According to King IV, the annual Integrated Report represents the voice of the governing body. As Directors, we owe our duties to the legal entity that is Transnet SOC Ltd. In acknowledging the diverse interests representing the Company, which include the interests of our Shareholder, our employees, customers and communities, we are duty-bound to act in good faith, not only in signing off on the year's performance but also in setting the direction and tone for Transnet's strategic aspirations going forward.

Given the brief period available to us to examine, approve and sign off the Transnet 2018 integrated reporting suite, we have relied heavily on the work done by Management and attempted to interrogate and provide our own observations where we could.

From the work of the various Board committees, it has become apparent that certain irregularities derive from lapses in financial discipline. While these irregularities do not necessarily



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Chairperson

result in fruitless and wasteful expenditure, it is evident that the corporate governance of the Company is inadequate and requires improvement, which enforces the dire need for strengthened controls, particularly in the procurement environment. Since the appointment of the new Board we have undertaken the following steps:

- Engaged certain forensic specialists to review the reports prepared relating to the much-talked about 1 064 locomotives contract, where Transnet has been accused of mismanaging the supply-chain management process resulting in associated costs increasing from approximately R38 billion to R54 billion.
- Formulated the key governance sub-committees of the Board.
- Abolished the ‘Acquisitions and Disposals’ (ADC) sub-committee, as we do not believe the Board should be directly involved in procurement processes.
- Commenced interactions with key state institutions charged with investigating “state capture”.
- Reviewed the progress of the investigations instituted by management, relating to payments made to companies identified in various media reports.

The reporting period was further marked by a credit downgrade of Transnet's foreign and local currency ratings, due to the rating action on the sovereign, as Transnet is viewed to be closely linked to the Government. The downgrades precipitated an increase in financing costs and a forced slowdown in capital expenditure, necessitating a need to supplement investments with capital raised through private-sector partnerships. The rating agencies have, however, noted significant growth potential for the country, even though they acknowledge that the new political administration will require time to improve economic growth, accelerate employment and stabilise the fiscal position, given the country's structural weaknesses.

¹ https://www.youtube.com/watch?v=w1NxcRNW_Qk



Together with management, we have set what we believe to be an ambitious but entirely achievable goal of restoring the integrity and reputation of Transnet. As a Board, with appropriately diverse skill-sets and depth of commercial experience befitting the task, we intend to ride the coat-tails of our President, who, in December 2017 began to usher in a new era of greater cooperation between the Government, business, labour and civil society, and to foster greater inclusivity in South Africa's policy environment, as evidenced by his success to date in his R1,2 trillion investment drive. His market-friendly approach and firm stance against corruption and maladministration is steadily building greater confidence among consumers, businesses and investors alike. In his words, "a restoration of confidence is the quickest and cheapest form of stimulus available, especially in light of our fiscal constraints." This is true at the macro-economic level for our country, and at the micro-business level for Transnet.

At the heart of the business is our obligation to assist in lowering the cost of doing business in South Africa, while ensuring security of supply by providing appropriate port, rail and pipeline infrastructure. As a SOC, Transnet must deliver on national developmental goals, as they pertain to the transport and logistics sector, ensuring that the country remains competitive on the continent and globally. In many respects, our country is a driving force for the growth and expansion of the African continent, with infrastructure to match any first-world country. This said, the World Bank and International Finance Corporation (IFC) rank South Africa in 39th place in the world for ease of doing business. Cost is of concern, particularly when trading across borders. The Company's Transnet 4.0 strategy, formally set in motion during the 2018 financial year, is geared to accelerate efforts to extend the Company's - and indeed South Africa's - commercial footprint in the fast-growing regions of Africa, the Middle East and Asia (AMEA), by offering affordable rail, port and pipeline infrastructure support to our cross-border neighbours. This vision proudly aligns with the "Africa 2063" strategic framework for socio-economic transformation of the continent over the next 50 years into a uniquely African trade environment, which fosters growth and sustainable development for Africans, by Africans.

The founding principles of the Transnet 4.0 strategy further echo a key tenet of the President's 2018 Address, in that our prosperity as a nation depends on our ability to take full advantage of rapid technological change. The new Board is committed to transitioning the business to adapt to global industry 4.0 trends, particularly in the ambitious goal of transitioning from our current second-party logistics provider (2PL) status to becoming a third-party logistics provider (3PL) in the short to medium term, and ultimately striving for fourth-party logistics provider (4PL) status in the long term. Ultimately, Transnet must progress with the times by becoming a digitally driven organisation, both from the perspective of driving efficiencies to lower business costs, and to innovate around new products and services.

It is prudent that we first and foremost guard against the financial, operational and governance challenges that have in recent years both directly and indirectly impacted negatively on the overall performance of the economy and, consequently placed pressure on the very fiscus we, as a SOC, serve to protect.

As the Transnet Board, we are committed to improving coordination, oversight and sustainability of the business, by enhancing internal governance oversight and supporting the Auditor-General to strengthen external audit processes. In this way, we hope to help restore public trust in Transnet as a SOC, a national infrastructure provider, a progressive business partner, and a national employer of choice.

We will also improve our engagements and interaction with various stakeholders, customers, service providers and emerging business.

Notwithstanding the various governance challenges experienced in recent years, we are convinced that Transnet can be an extraordinary company that, given the opportunity, will grow and impact positively on the economy of our country. A valuable point of departure is to restate Transnet's core mandate, particularly as it facilitates the broader economic and developmental goals of the country as articulated by President Cyril Ramaphosa in his 2018 State of the Nation Address (SONA); and to express our own understanding of and commitment to the mandate bestowed on us as the new Board in steering the Company towards its vision. The excellent financial performance appears clearly in the Annual Financial Statements and is further articulated in the Executive summary of the Group Chief Executive and Acting Chief Financial Officer.

Condolences

Regrettably, during the year five employees passed away in our operations. On behalf of the Board of Directors, we wish to express our heartfelt condolences to their families and all who were touched by their passing. The Company also lost a friend and mentor in Gideon Mahlalela, whose passing two days before year-end was sudden and unexpected.

We further wish to convey our sympathies to the families of the 102 members of the public who lost their lives during the year in and around our operational activities. As the Board, we undertake to review the nature and causality of all fatalities and do our best to entrench Group-wide safety awareness.

Appreciation

We wish to acknowledge the ongoing efforts by all Transnet employees. As the Board, we appreciate that the 2018 reporting year was harrowing, given the pervasive and sustained media reports on State Capture, which cast a cloud over many SOCs, Transnet included. As disheartened as many might feel at this time, we owe it to ourselves and our colleagues to remain strong and grounded. We also wish to thank the leadership of organised labour for their guidance, leadership and willingness to share in the Company's long-term vision.

Thank you to our customers and commercial partners for your support and confidence in our abilities amid difficult economic and operational conditions during the year. As the new Board, we look forward to learning more about our customer environment and to finding innovative ways to improve Transnet's service offerings to you.

Our sincere gratitude to the Minister of Public Enterprises, Mr Pravin Gordhan - who represents our Shareholder and the people of South Africa - for his confidence in our ability to deliver on our DPE mandate, for his encouragement, guidance and his belief in the leadership to take Transnet forward. On behalf of the Board of Directors, we pledge our unwavering support for his vision for our company.

Our deep appreciation to our regulators, including ministries with which we work closely; as well as various committees in Parliament; provincial governments; and municipalities that contribute their oversight responsibilities and partnership commitments. To community partners across the country, we are privileged to serve as the custodians of South Africa's largest infrastructure state-owned company. We look forward to partnering with you in our various enabling projects.

PS. Molefe

PS Molefe
Chairperson

10 August 2018
Johannesburg

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"The erosion of trust in SOCs and public institutions has negatively affected our social licence to operate. Our challenge is to win back the trust of the public, investors and Government. The only way to do this is to demonstrate unwavering commitment to good corporate governance."

Dr Popo Molefe
Chairperson



Executive summary

Revenue growth and profits have been erratic for many transport and logistics companies over the last 10 years, with revenue increasing but profits not matching up to the rate of revenue increases on average. Return on capital employed (ROCE) and profits are relatively low for many companies in this sector compared to other industries, such as technology, consumer non-durables and retail.

Despite the challenges faced during the year, the Company has achieved unparalleled financial results for the year ended 31 March 2018. Revenue for the year increased by 11,3% to R72,9 billion. Stringent cost-containment measures and working capital management contained operating costs at R40,4 billion (2017: R37,9 billion), a 6,5% increase, resulting in a R3,1 billion saving against planned costs. As a result, earnings before interest, taxation, depreciation and amortisation (EBITDA) – Transnet's key measure of profitability – increased by 18% to R32,5 billion (2017: R27,6 billion and 2016: R26,3 billion), with the EBITDA margin increasing by 2,4% to 44,6%. Gearing at 43,4% and cash interest cover at 3,0 times were well within the approved financial parameters.

Revenue performance was underpinned by solid growth in strategic rail sectors:

- 6,1% increase in port containers
- Record general freight volumes of 90,8 mt, an increase of 3,1% from the prior year
 - 6,5% growth in railed containers and automotive volumes
 - 17,5% growth in chrome
 - 13,2% increase in manganese
- Record of 77,0 mt export coal volumes (Richards Bay Container Terminals)

Progress on major projects is also largely on track with 402 locomotives from the 1 064 locomotive programme having been accepted into operations during the year, and 16 more delivered and currently undergoing acceptance testing. Further, Transnet has commenced its manganese expansion project, which aims to expand the capacity for transporting manganese volumes beyond 5,5 million tonnes (mt). South Africa accounts for 75% of globally identified manganese reserves and 31% of manganese exports by value, making it a sustainable, lucrative supply market to Europe and China. During the year, demand for manganese exceeded budget by a substantial 46,6%.

R1,3 billion was invested in the NMPP project during the year. The coastal terminal (tight-line solution), inland terminal, 24" main pipeline and 16" inland pipelines have been fully commissioned and are operational, having transported more than 199,48 billion litres of diesel from Durban to the inland region since commissioning. Following the coastal terminal commissioning in August 2017, the pipeline is now operating as a multi-product pipeline (various grades of diesel and petrol) functioning at full phase 1 flow rates, thereby securing fuel supply for the South African economy over the medium to long term. The inland terminal was commissioned and became fully operational in December 2017.

Transnet has initiated various geographic expansionary projects under a new subsidiary, Transnet International Holdings (TIH) SOC Ltd, such as the Nigerian railway concession project worth approximately \$2 billion; the approval of a private-sector participation investment proposal to operate three berths in the Port of Lamu, as per the LAPSSET Corridor Memorandum of Understanding (MOU) signed between South Africa and Kenya in 2016; and a tender awarded to the Transnet-Diaspora Infrastructure Development Group (DIDG) Consortium to raise finance for the rehabilitation and renewal of key equipment, systems and infrastructure for the National Railways of Zimbabwe.

Other important developments relating to our advanced manufacturing sector include the launch of the TransAfrica Locomotive during April 2017 and the prototyping of a fully autonomous (self-drive) Special Inspection Device (SID) in collaboration with the Council for Scientific and Industrial Research (CSIR) to detect obstacles on rail ahead of travelling trains. We are hopeful that the SID's capabilities will revolutionise rail safety.

We are actively leveraging technological advancements to improve operational efficiencies. Technologies such as the Internet of Things, Machine Learning and Artificial Intelligence (AI) will provide valuable insights into improving operational reliability and service delivery to customers; whereas blockchain technology will modernise legacy systems and offer new customer service platforms. The aCTES system – serving as an industry-wide service platform – will help to generate relevant transportation and logistics data from multiple sources across the entire transport eco-system, thereby radically enhancing our customers' experiences across the logistics value chain.

Going forward, Transnet's growth will rely on our ability to diversify value-added services, and to harness some of the megatrends shaping the global transport and logistics sector. This implies diversifying revenue streams to tap into logistics opportunities presented by rapidly developing economies, such as logistics advisory services, infrastructure development and freight forwarding over large distances. Consolidation of the logistics sector, where larger players acquire small or niche players, is also a growing trend in the transport and logistics sector, in part due to companies' reduced payloads, low profitability levels and evolving customer preferences. In terms of the latter, our own customer surveys reflect that we are still slow to respond to their fast-changing requirements, which is a combined factor of our systems, customer support structures and our organisational culture, all of which need to undergo a fundamental transformation.

"We are committed to improving coordination, oversight and sustainability of the business, by enhancing internal governance oversight"



Mr Siyabonga Gama
Group Chief Executive



Mr Mohammed Mahomed
Acting Chief Financial Officer

Our point of departure draws from our view of long-term sustainability. As a SOC, we cannot defer our developmental mandate. Hence, our sustainable developmental outcomes form part of the essential blueprint for our new strategic direction. This means we need to consider our local suppliers in our expansion aspirations, acknowledge the new ways in which many 'new economy' enterprises and youth entrepreneurs work so that they benefit from our enterprise development programmes, involve our communities in our move to 'digitalisation', and consider developing the technologies and skills we will need 30 years from now.

S.I. Gama

SI Gama
Group Chief Executive

M. S. Mahomed

MS Mahomed
Acting Chief Financial Officer

10 August 2018
Johannesburg