WERKSMANS
ATTORNEYS

PRIVILEGED AND CONFIDENTIAL

ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET'S GENERAL FREIGHT BUSINESS ("TRANSACTION"): INQUIRY

REPORT

VOLUME V

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TRANSNET

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MEMORANDUM

To: Brian Molefe, Group Chief Executive Officer

From: Anoj Singh, Group Chief Financial Officer

Date: 21 February 2014

SUBJECT: APPROVAL TO SEND LETTER TO THE MINISTER OF FINANCE FOR THE ACQUISITION OF 1064 LOCOMOTIVES – RESPONSE TO QUERIES RAISED

PURPOSE:

1. The purpose of this memo is for the GCE to recommend the attached letter to the Chairman's Office for signature to the Minister of Finance.

BACKGROUND:

2. In terms of the PFMA Transnet is required to obtain approval from the Shareholder when making a capital acquisition that exceeds 1% of the Transnet asset base.

3. Transnet is also required to notify the National Treasury of the acquisition in addition to seeking approval from the Shareholder Minister. Transnet's application and notification was lodged with the respective ministers on 2 May 2013.

4. The National Treasury provided their response to Transnet on 31 October 2013 (attached for your ease of reference). Group Capital Integration and Assurance (GCIA) received the Finance Minister's letter on 14 January 2014. The request was actioned immediately to Freight Rail for input which was provided on 23 January 2014.

DISCUSSION:

5. The attached letter to the Minister is prepared for your review. All necessary documents and supporting information is attached.

6. Transnet has also offered to engage with the Minister should further clarity be required.

FINANCIAL IMPLICATIONS:

7. There are no financial implications relating to this memo as it is a request to approve a letter addressing concerns to the Minister of Finance.

BUDGET IMPLICATIONS:

8. Due to the reasons indicated above there are no budgetary implications relating to this memo.

APPROVALS AND DELEGATIONS:

9. The letter from the Minister of Finance is addressed to the Chairperson. The GCE is required to approve the letter that will be submitted through the Chairperson's Office to the Minister of Finance.

RECOMMENDATION:

10. It is recommended that the GCE recommends the attached letter to the Chairperson's Office for signature to the Minister of Finance. A copy of the letter will also be provided to the Shareholder Minister (Public Enterprises).

Recommended by:

Siyabonga Gama
Chief Executive: Freight Rail
Date: 2014.02.21

Recommended by:

Anoj Singh
Group Chief Financial Officer
Date: 21/02/14

Recommended by:

Brian Molefe
Group Chief Executive Officer
Date: 11.3.14

Approved by:

Mafika Mkwanazi
Chairman
Date: 11/03/2014

M13/5/1/1/7

MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

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Ref. M4/1/20 (1295/13)

Mr Mafika Mkwanazi
Chairperson of the Board
Transnet SOC Ltd
P O Box 72501
PARKVIEW
2122

Dear Mr Mkwanazi,

TRANSNET'S APPLICATION IN TERMS OF SECTION 54(2)(d) OF THE PUBLIC FINANCE MANAGEMENT ACT FOR THE ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET FREIGHT RAIL'S GENERAL FREIGHT BUSINESS

I have noted Transnet's intention to acquire 1064 locomotives over the next seven (7) years at an estimated cost of R38,6 billion. I am aware that the acquisition aims to facilitate the ramp up in volumes transported from the current 80 million tons to 170 million tons as envisaged in the Market Demand Strategy (MDS) which forms the basis of Transnet's 2013/14 Corporate Plan.

However, I am concerned that the profitability of the project is highly dependent on Transnet's General Freight Business (GFB) being able to grow the volumes transported at amounts above GDP growth and tariffs charged at above CPI. Failure to achieve these optimistic growth figures would have an adverse effect on the expected revenues and thus the profitability of the project. Moreover, potential fluctuations in the operational costs could also adversely affect the profitability of the project.

Wagons. Mfa

The success of the project entails further capital expenditure, including the purchase of wagons and other expansionary expenditure is incurred. Therefore, I will be expecting a further Section 54(2) disclosure on all the relevant capital expenditure associated with the project. Furthermore, Transnet must submit a detailed implementation plan demonstrating how the above GDP growth volume increases and the above inflation tariff increases anticipated in the MDS will be achieved together with the possible mitigation strategies. In addition, operational costs must be monitored and rigorously controlled throughout the lifespan of the project to avoid any cost escalations.

Moreover, I have noted that, whereas Transnet is claiming that increasing locomotive capacity and efficiency will lead to lower tariffs for customers; real increases in tariffs

are in fact being projected to sustain the project. Transnet must provide regular feedback to National Treasury on their initiatives to attract customers from road to rail.

I look forward to the finalisation of the project and request that Transnet submit quarterly feedback to National Treasury on the status of the acquisition and the above mentioned related issues.

I trust that you will find the above to be in order.

Yours sincerely

PRAVIN J GORDHAN
MINISTER OF FINANCE
Date: 30 - 10 - 2015

cc Mr MKN Gigaba, MP
Minister of Public Enterprises

Appendix 40 770

public enterprises

Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

DECISION MEMORANDUM

TO : **MR. MALUSI GIGABA, MP**
MINISTER OF PUBLIC ENTERPRISES

FROM : **MS. KGOMOTSO MODISE**
DEPUTY DIRECTOR-GENERAL : TRANSPORT

FILE REF : **16/1/12/R**

IDMS REF : **158980**

SUBJECT : **TRANSNET PFMA APPLICATION FOR THE ACQUISITION OF 1064 LOCOMOTIVES**

DATE : **13 JUNE 2013**

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1. PURPOSE

1.1 To advise the Minister with regard to Transnet's application in terms of Section 54 of the Public Finance Management Act (Act No.1 of 1990 (PFMA) for approval to invest R38,6 billion in the acquisition of 1064 locomotives for Transnet Freight Rail's (TFR) General Freight Business (GFB) over the next seven years. Transnet's original section 54 application is attached hereto as **Annexure "B".** —▷

1.2 To request Minister to sign the letter attached hereto as **Annexure "A"**, to the Chairperson of Transnet approving the application with conditions if in agreement of the contents thereof.

2. SUMMARY

2.1 Transnet's 2013/14 Market Demand Strategy (MDS) has projected a 90mt growth in General Freight Business (GFB) volumes, i.e. from 91mt in 2013/14 to 170mt in 2018/19. In order to achieve this stretched target, Transnet had allocated R143bn of the initial MDS

DG's OFFICE 11 JUL 2013

R301bn capital programme to invest in GFB infrastructure and rolling stock in order to increase capacity.

2.2 There has been no investment in GFB locomotives between 1992 and 2008 and the average age of the current GFB fleet of 1889 locomotives is 32 years, whereas the design life of a locomotive is 30 years. In addition, 374 of these locomotives are expected to be written off over the next seven years; as these locomotives would have reached the full life span and have become too expensive to maintain.

2.3 In order to address the challenge of aging locomotives, which affects the delivery of MDS volume demands, Transnet proposes to invest approximately R38 billion in the acquisition of 1064 locomotives (599 electric and 465 diesel) to enable TFR to deliver the MDS GFB target of 170mt by 2018/19. This will result in a positive NPV and an increased return on assets (ROA). It is also expected to lower the cost of doing business by improving operational efficiencies, creating and preserving 28 000 direct and indirect jobs while creating R68 billion in economic impact through local supplier development.

2.4 Further, the benefits of the acquisition include, inter alia, the creation of Transnet Engineering's (TE's) localisation opportunities, sustainable development of the SA locomotive production industry through consistent annual demand over the next seven years, skills development and job creation. In achieving this, the strategic role of TE as a catalyst in rail industrialisation will have to be clarified. This would be characterised by TE playing a role as a strategic localisation and supplier development agency for the rail and ports industry as a whole.

2.5 In order to maximise the localisation and transformation opportunities from this acquisition, Transnet will apply a procurement strategy which is geared towards increasing the weighting of supplier development and Broad-Based Black Economic Empowerment (B-BBBE). Through this procurement strategy, Transnet could achieve as much as 70% localisation from this procurement at a relatively small price premium. The level of localisation targeted is informed by the current capability of local suppliers and the choice of components to be localised. The choice of components to be localised is dependent on the technological complexity of the production of the component and the economies of scale that can be derived in localising that component.

2.6 Overall, the detailed business case and explanatory engagements with Transnet confirm there is a need to replace the ageing locomotive fleet if the MDS strategy and 2013/14 Corporate Plan are to be realised. In view of the strategic nature of the locomotive

acquisition, the Department recommends that Minister approves Transnet's 1064 acquisition application.

3. ANALYSIS AND FINDINGS

3.1 Introduction

3.1.1 On the 2nd of May 2013, Transnet submitted a section 54 PFMA application for Minister to approve the acquisition of 1064 locomotives that is estimated to cost R38.6 billion. This acquisition has been included in the overall MDS investment and funding plans.

3.1.2 The acquisition comprises of the procurement of 465 diesel and 599 electric locomotives by TFR over the next seven years aimed at replacing the current aged fleet and supporting the MDS to ramp up GFB volumes from the current 91mt in 2013/14 to 170mt by 2018/19.

3.1.3 According to the PFMA, Minister has to provide a response within 30 days for the submission date. The 30 day period has however, lapsed due to the necessary due diligence processes undertaken to satisfy ourselves as the sector unit regarding the merits of the business case. There were two engagements between Transnet and the Department's officials that took place since submission of the business case as part of the due diligence process.

3.2 Business need and fleet requirements

3.3.1 As part of the road to rail initiative, TFR has committed to grow its total volumes from the current 208 mtpa to 350 mtpa by 2019. Rail currently only has a market share of 11,5% in respect of tonnes freighted and 29% in respect of tonne-km freighted TFR growth in GFB volumes is expected to increase from the current 40% of total volumes to 49% by 2018/19. The majority of the growth in GFB demand will be generated by rail-friendly bulk commodities that need to be transported over long distances such as manganese, magnetite, and domestic iron ore. Bulk commodities, such as coal needed for Eskom's power stations and container-based commodities for which existing demand moves on road, is also expected to shift to rail.

3.2.2 In order to achieve these MDS targets, TFR has planned to invest a total of R194bn over the seven year period. Of the R194bn, R143bn has been allocated to the GFB business which has been historically plagued with inefficiencies. These inefficiencies have to a large degree been caused by the use of an aged locomotive fleet.

3.2.3 Due to the lack of investment in GFB rolling stock in the past, TFR has suffered higher faults per million kilometres, lower gross tonne kilometres, and substantially higher maintenance costs. This has decreased customer satisfaction, leading to a shift from rail to road.

3.2.4 The average economic design life of a locomotive is 30 years and TFR's current locomotive fleet is 32 years old. There have been no new locomotive acquisitions between 1992 and 2008, until the GFB fleet was augmented with 50 "like new" diesels, 143 diesels and 95 electrics. Life extension of the current fleet has resulted in high maintenance costs and difficulty in obtaining replacement parts.

3.2.5 TFR's current locomotive fleet plan indicates that the fleet complement will decline from 1889 in 2014 to 1592 by 2019, a further reduction to 50% of the fleet in ten years and a totally retired fleet in twenty years. If this is not addressed, TFR will only be able to transport 85 mtpa by 2019, which will be 85 mtpa short of its MDS target.

3.3 Proposed solution

3.3.1 To meet the fleet requirements necessary to support the MDS volumes, TFR needs to procure 1064 new locomotives with built-in flexibility in the procurement contract to account for demand fluctuations and operational efficiencies. This will enable the appropriate timing of the delivery of locomotive requirements.

Volumes vs. Locomotive capacity

VOLUMES (PER NET TONNE)	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Existing fleet	83	82	100	106	92	85
1064 locomotives	1	7	21	41	60	77
Volume shortfall	*7*	*15*	*6*	*4*	*9*	*8*
MDS target	91	104	127	151	161	170

3.3.2 The first line on the table above reflects million tonne volume capacity provided by the existing fleet over the remaining original MDS period, the second line reflects additional capacity added by acquisition of the 1064 locomotives and the third line reflects a volume shortfall (which will peak at a considerable risk in 2014/15) due to the limitations in locomotive capacity.

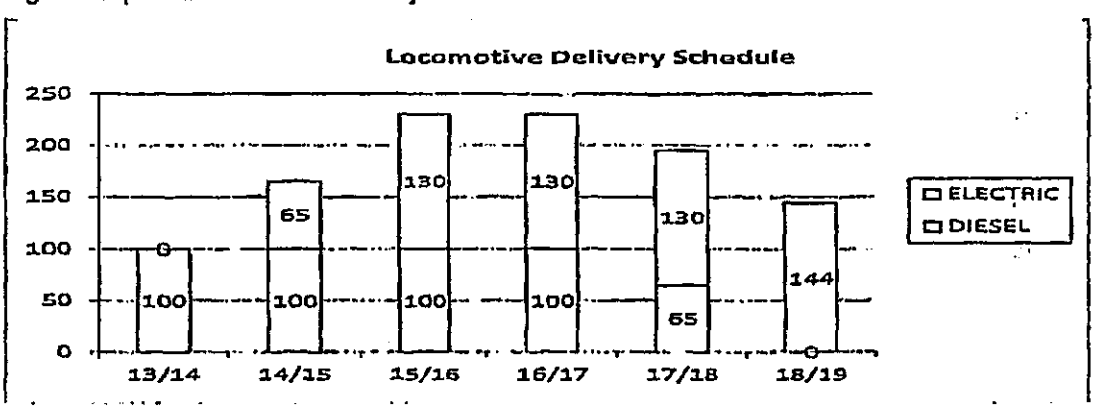
3.3.3 The shortfall will be mitigated by increasing locomotive optimisation, which entails improved rolling stock utilisation planning and execution. The total revenue shortfall in the

case where no locomotives are purchased and only the existing fleet can therefore be utilised, stands at R73 billion during the period 2013 /14 to 2018/19.

3.3.4 A further benefit of the acquisition will be increased standardisation of the fleet which will lead to resolving both operational and maintenance difficulties such as training drivers, planning route design,s and maintaining locomotives. The proposed diesel locomotives can operate over most of the network with notable exception of long tunnels. Current single voltage electric locomotives are confined according to the current electrified network. This imposes operational inefficiencies due to the traction changes. The new electric locomotives will be dual voltage, eliminating the need to change tractive power and enabling trains to bypass operational yards – thereby increasing efficiencies.

3.3.5 The graph below reflects the proposed locomotives delivery schedule. Based on this proposed schedule, in the first two years, priority will be given to diesel locomotives and from the third year onwards, electric locomotives will be accelerated. Due to the current strain and uncertainty in the country's electricity supply, may be beneficial to prioritise diesel locomotives in the earlier part of the contract.

Fig 1. Proposed locomotive delivery schedule



3.4 Impact on TE

3.4.1 TE will be significantly impacted by the procurement of the 1064 locomotives, shifting from a maintenance-oriented organisation with relatively smaller builds to a manufacturing oriented organisation. The new deployment plan will also significantly alter the way TE operates as the new locomotives would have added features that will reduce maintenance and increase reliability. The positioning of TE as a manufacturing entity with one or more OEMs will be influenced by the procurement as articulated in the RFP.

3.4.2 It is recognised that the role of TE in the locomotive procurement will be determined once bids have been received, relevant OEMs engaged with and the ultimate procurement contract entered into. However, the Department's objective is that TE becomes a rail and ports manufacturing powerhouse for Africa. The Department is looking to position TE as a strategic localisation and supplier development agency for the rail and ports industry as a whole.

3.4.3 In order for this to become a reality, it is necessary to provide TE with a base-load of work to build strategic capabilities, whilst also ensuring that it becomes cost competitive, process efficient and a high quality producer. The Department needs to understand TE's relative role versus that of the private sector and consequently a description of these respective roles. TE should also detail its locomotive supply chain strategy to specify what is being imported, what it is producing, what is being outsourced to the private sector and the broad conditions associated with outsourcing that will result in a competitive national industry. Such conditions may include industry competitiveness benchmarking, investment in plant and skills and the requirement that the industry masters quality and lean manufacturing disciplines as part of the long-term contract. The Department is particularly interested in the localisation strategy flowing from the procurement and the role of TE in the strategy for the following strategic components: traction convertor, traction motor, diesel engine, bogies, electrical systems, management system and control system.

3.5 Project strategic fit

3.5.1 The investment in growing GFB volumes is anticipated to make business sense, as it lowers the cost of doing business and accelerates a modal shift from road to rail. The majority (85%) of the growth in GFB demand is generated by: rail-friendly bulk commodities that need to be transported over long distances such as manganese, magnetite, and domestic iron ore; bulk commodities with specific demand, requirements such as coal needed for Eskom's power stations; and container-based commodities for which existing demand moves on road and will shift to rail.

3.5.2 In addition, the MDS promises to promote localisation, transformation and empowerment. The following localisation and transformation initiatives are proposed:

- International suppliers to transfer knowledge and expertise to up-skill local suppliers
- On-the-job training and apprenticeships to be built into international supplier contracts
- Provision of jobs and procurement opportunities to rural areas where facilities are located

- Assistance to be provided to businesses will serve to foster innovation and create jobs
- R4,2bn expected to be spent over the next 7 years on small business promotion
- Collaboration with suppliers to meet Government's transformation and empowerment objectives.

3.5.3 Whilst, from a high level, the project seeks to address rail market re-capture and localisation, there is a lack of detail on how Transnet intends to create the modal shift. Elements of a specific modal shift strategy that involve corridor analysis and other business model planning is lacking and needs to be addressed. A condition pertaining to the above is therefore included in the letter attached hereto as **"Annexure A"**.

3.6 Financial analysis

3.6.1 From a financial perspective, the key value propositions of this project include:

3.6.1.1 Revenue growth with an acceptable tariff increase (in line with the compacted target of CPI+2%)

3.6.1.2 A positive Net Present Value (NPV): The NPV is a financial calculation used to determine the profitability of the project in today's Rand terms. The NPV is calculated by discounting future cash flows based on the Weighted Average Cost of Capital (WACC), to determine what these cash flows are worth today, less than the initial investment. If the difference is positive, the investment should be made. If the difference is negative, it means that the project is destroying value.

3.6.1.3 Enhanced Return on Assets (ROA)

3.6.2 Since TFR is an integrated business, i.e. some assets and corporate services are shared between the Business Units, the NPV calculation in the business case was based on TFR as a whole rather than the project itself.

3.6.3 The business case was built on two scenarios as highlighted below:

3.6.3.1 *The "do nothing" scenario*

The MDS is premised on Transnet's ability to generate cash flows internally in order to fund 2/3 of the R307bn CAPEX programme. Based on TFR's current Locomotive Fleet Plan, the number of locomotives in the GFB fleet will decline from 1889 in 2014 to 1592 by 2019. If this run-out is not addressed, TFR would only have capacity to transport 85 million tonnes in 2019, representing a cumulative revenue shortfall versus the MDS plan of R73 billion over this period. The impact of this revenue shortfall would lead to failure of the MDS.

3.6.3.2 *The new locomotive procurement scenario*

TFR supports its planned volume ramp-up through investment in new locomotives to replace the current aged fleet. Procuring 1064 new locomotives between 2013/14 and 2018/19 would have a positive NPV of R2.7 billion (discounted using TFR's hurdle rate of 18.56%; NPV would be R34.1 billion if discounted using TFR's WACC of 12.56%). The hurdle rate is higher than the WACC rate because it factors in additional project specific risks.

3.6.4 The 1064 locomotives are expected to cost R38.6bn in total, assuming that the current exchange rates prevail, the amount comprises 465 diesel locomotives at an average price of R25 million each and 599 electric locomotives at approximately R34 million each. These estimated prices include a 2% localisation premium. Electric locomotives are initially more expensive to purchase, primarily as a result of significantly higher development costs as more customisation is required than in the case of diesels. However, running costs are lower for electric locomotives, making them less costly in the long run.

3.6.5 In addition to the project cost of R38.6bn, associated capital costs will be spent on wagons and infrastructure through separate projects, to an approximate amount of R17.5bn and R26.5bn respectively, to complement the additional locomotives.

3.6.6 According to the revised MDS, two thirds of the R307bn seven year capital investment plan will be funded from internally generated cash flows and the balance will be funded externally. Similarly, the locomotive plan of R38.6 billion will be funded from internally generated funds (two thirds) and the balance of R13 billion from external sources (one third).

3.6.7 Payment arrangements of locomotives will be carried out as follows: 90% on delivery and 10% on acceptance.

3.7 Operational rediness and infrastructure

3.7.1 TFR will require an additional 3 065 drivers in order to operate the additional locomotives. However, it only has capacity to train an average 500 drivers per year and, at its peak in 2015-2016, TFR will require an additional 791 drivers; this is emanating from shortage of train drivers. Over the MDS period, TFR will have a shortfall of 529 drivers.

3.7.2 In response to this challenge, TFR has now changed its mandatory Refresher Training that was required every 2 years, to a Continuous Professional Learning programme.

Training time has been reduced from 22 days to 6 days. This will effectively free up capacity at the School for additional training of new recruits. TFR will need to start training new drivers immediately to close the driver shortfall before the peak demand period in 2015/16.

3.7.3 Sustaining and expanding investment in infrastructure and other key projects within the system will be critical to support MDS delivery and thus TFR will also invest in projects to sustain and expand its rail network capacity. The strategy pursued by TFR over the 9-year planning horizon covers two key strategic focus areas to enable volume growth and systemically improve the safety of operations i.e expand infrastructure, create capacity ahead of demand and Sustain existing infrastructure through accelerated maintenance programmes.

3.8 RISKS

A summary of key risks reported by the SOC and those identified by the shareholder is outlined below. **Annexure "C"** sets out the full risk analysis conducted for on the application.

3.8.1 Critical Skills Attraction and Retention

The ability to attract, develop and retain critical skills could affect the delivery and operation of the new fleet including the plan to transform TE into a manufacturing oriented company. Therefore, Transnet should outline its proposed human resource plan indicating how TE and TFR will attract and retain critical skills while ensuring the development and empowerment of previously disadvantaged groups.

3.8.2 Energy supply

There is a risk that Transnet could be left with non-operational assets given that the electric locomotives would require sustainable energy supply to operate optimally. The current energy reserve margins are tight and with the challenges faced on the construction of power stations by Eskom, there may be a need to prioritise the acquisition of diesel locomotives in the short-term period.

3.8.3 Contract Risk

Transnet could suffer losses caused by poor contractor performance or the poor performance of locomotives upon delivery and as such requires adequate protection against the possibility of this significant risk. However, the Department is concerned that protection could be achieved in a manner that undermines government's efforts to drive small enterprise development or support through projects similar to this one. Therefore,

Transnet should outline how it plans to achieve a balance between *sustainable* small medium enterprise support/development and the need to indemnify the company from risks arising from supplier or product performance.

3.8.4 Preservation and Growth of Shareholder Value

There is a risk that government may miss an opportunity to leverage the capabilities possessed by other state-owned companies in executing this project. Denel in particular possesses advanced manufacturing capabilities that could be leveraged to support the project and to gradually develop TE's manufacturing capability. Therefore, Transnet should be encouraged to explore Denel's capabilities as they could present efficiency gains.

3.8.5 Fraud risk

Fraud risk is inherent in any procurement process. However, in a project of this magnitude a realisation of this risk would significantly erode value and could damage the reputation of the SOC and that of the Shareholder. Therefore, the Shareholder should be immediately notified of any fraudulent incidents above R5 million so that the cases could be referred to and be overseen by the government's Anti-Corruption Task Team which is led by National Treasury.

3.8.6 Effectiveness and Efficiency of Project Delivery

There is a risk of project cost overrun and project delay which could be triggered by key factors such as labour unrest, fluctuations in purchase price and foreign exchange fluctuations.

3.8.7 Volumes shortfall

The MDS is based on a number of economic assumptions. If there are material changes in the economic assumptions and the expected volumes do not materialise, the project's viability will be under threat.

3.8. Procurement Strategy

3.9.1 The procurement of rolling stock and in particular the 1064 locomotives provide Transnet and the country a unique opportunity to strategically re-position the rolling stock industry for both localised assembly and localised manufacture of component parts.

3.9.2 The procurement strategy, which informed the RFPs, focuses on Broad Based Black economic empowerment and is all inclusive, has the potential for creating employment on

a large scale; and includes the local content percentages as detailed in the National Treasury Instruction Note issued on the 16th of July 2012, which highlights a local content percentage of 55% for diesel and 60% for electric locomotives.

3.9.3 The expected economies of scale in purchasing 1064 locomotives are sufficiently large so as to create localisation opportunities that could increase the percentage of localisation above these minimum thresholds at a low additional price premium. The extent to which localisation can be achieved is calculated on a component by component basis as each component that is currently not localised requires a specific business case and strategy to be localised. The two main factors that increase the cost of localisation are technological complexity in the production process and the need for high production volumes to make the production runs cost-efficient.

3.9.4 Based on a component by component analysis, it has been established that Transnet could achieve a high level of localisation at relatively low price premiums. For diesel and electric locomotives, localisation of 70% and 77% respectively could be achieved at an average price premium of less than 2%. This price premium is calculated as the average price premium paid for a locomotive – i.e., including some items with no price premium and others such as engine assembly with an estimated 8% price premium. This 2% localisation premium is expected to yield an economic impact of R78 billion for South Africa.

3.9.5 In driving this localisation and transformation objectives, Transnet has formulated a tender evaluation methodology that increases the weighted scoring for supplier development and Broad-Based Black Economic Empowerment (B-BBEE), i.e. the 60/20/20 approach, 60% for price, 20% for supplier development and 20% for B-BBEE. This approach to localisation targets is expected to create 30% greater total economic benefit than that of the traditional 90/10 approach which is required by the PPPFA, 90% being price and 10% B-BEE. The 1064 procurement has been granted exemption from the Preferential Procurement Policy Framework Act (PPPFA) and thereby allows Transnet to apply the 60/20/20 approach.

TRANSNET PFMA APPLICATION FOR THE ACQUISITION OF 1064 LOCOMOTIVES

4. FINANCIAL IMPLICATIONS

None for the Department

5. CONSULTATION/PROJECT TEAM

Martin Malapane, Clive Selwadi, Neelesh Amardas.

6. RECOMMENDATION

6.1 It is recommended that the Minister takes note of the following:

6.1.1 Based on the above analysis and engagements with Transnet, the fulfilment on the MDS is highly dependent on a locomotive replacement plan.

6.1.2 The acquisition of the 1064 locomotives will result in a positive NPV of R2.7 billion based on a Transnet hurdle rate of 18.56% and an NPV of R34.1 billion based of a Transnet WACC of 12.56%.

6.1.3 In ensuring that maximum localisation and transformation benefits are derived from this acquisition, Transnet will apply a procurement strategy that is geared towards increasing the weighting of supplier development and B-BBE.

6.1.4 Through this procurement strategy, Transnet could achieve as much as 70% localisation from the acquisition of the 1064 locomotives at a relatively small price premium of 2%.

6.2 It is recommended that the Minister approves the acquisition of the 1064 locomotives with the condition that Transnet provides the Department with the following:

6.2.1 Clarity with regard to TE's relative role versus that of the private sector, including the description of these respective roles;

6.2.2 TE's locomotive supply chain strategy which illustrates what is being imported, what TE is producing, what is being outsourced to the private sector and the broad conditions associated with outsourcing which will result in a competitive national industry.

6.2.3 A localisation strategy flowing from the procurement and the role of TE in the strategy for the following strategic components: traction convertor, traction motor, diesel engine, bogies, electrical systems, management system and control system.

6.3 It is recommended that the Minister signs the letter **(Annexure A)** to the Chairman of Transnet if in agreement with the contents thereof.

TRANSNET PFMA APPLICATION FOR THE ACQUISITION OF 1064 LOCOMOTIVES

Memorandum prepared by:

pp.
DION HAROLD
D: TRANSPORT
DATE: 13/06/2013

NGOAKO HUMA
ACD: TRANSPORT
DATE: 13/06/2013

FEMIDA MAHOMED
CD: STRATEGIC PARTNERSHIPS
DATE: 18/06/2013

REVIEWED AND SUPPORTED:

MELANCHTON MAKOBE
CD: LGRT
DATE: 13/06/2013

EDWIN BESA
ACTING DDG : TRANSPORT
DATE: 11.7.2013

M.A.
MS. MATSIETSI MOKHOLO
ACTING DIRECTOR-GENERAL
DATE: 11/07/2013

RECOMMENDED / ~~NOT RECOMMENDED / COMMENTS~~

MR. MALUSI GIGABA, MP
MINISTER
DATE: 2013/08/03

APPROVED / NOT APPROVED / COMMENTS

I'd expect that there'll be set-aside for youth and women on this procurement.

MR. BULELANI GRATITUDE MAGWANISHE, MP
DEPUTY MINISTER
DATE:

RECOMMENDED / NOT RECOMMENDED / COMMENTS

public enterprises
Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

Public Finance and Management Act (PFMA) Section 54 Questionnaire for inclusion in Rolling Stock Acquisition Programme

Rolling Stock Acquisition Programme

The PFMA Section 54 Applications submitted by Transnet should address the following questions in order to secure approval for the application:

Note: All questions listed below are relevant over the period of the MDS and beyond. All data requested must be provided for each year of the MDS in Excel format on a CD as part of the application for the purpose of analysis. The underlying assumption and calculations must be included in the spread sheet.

1. Market Analysis – demand and supply

1. What are the underlying assumptions for quantifying demand?
2. The concept of "unconstrained demand" must be qualified in the context of total national demand and that of Transnet's existing customer demand over the period of the MDS and beyond i.e. what demand is the MDS addressing? This must be clarified.
3. Market (commodity) trends, drivers of growth and economic impact. This should include an economic impact analysis (simple extrapolation of historical time series should be avoided as far as possible)
4. Commodities: (kindly provide data by commodity, by year)
   a. Total market for all commodities at the end of MDS and beyond;
   b. Total market for all railable commodities at the end of MDS and beyond;

c. TFR's current share of total market for railable commodities;
d. TFR's share of total market at the end of MDS and beyond;
e. Current modal split i.e. road, rail and pipelines for all commodities;
f. Expected modal split i.e. road, rail and pipelines for all commodities at the end of MDS and beyond;
g. Ideal modal split i.e. road , rail and pipelines for all commodities at the end of MDS and beyond;

5. Key assumptions underpinning the increase in rails share and other key success factors or enablers to gain market share;
6. Key risks and/or threats to achieving increase in rail market share;
7. All commodities should be presented in the framework of the BCG matrix, ie diamonds, rising stars, dogs etc. This should be accompanied by revenues in rand value and a percentage (%) of total revenue.

2. Fleet Analysis

1. A full breakdown of the existing wagon and locomotive fleet in terms of:
   a. Category;
   b. Number of units (i.e. number of wagon and locomotives respectively);
   c. Purpose (commodity type used);
   d. Utilisation;
2. A full breakdown of the MDS rolling stock acquisition programme (procured wagons and locomotive fleet over the period of the MDS) in terms of:
   a. Category;
   b. Number of units (i.e. number of wagon and locomotives respectively);
   c. Purpose (commodity type used);
   d. Expected utilisation;
3. A full breakdown of the total wagon and locomotive fleet post MDS in terms of:
   a. Category;
   b. Number of units (i.e. number of wagon and locomotives respectively);
   c. Purpose (commodity type used);
   d. Expected Utilisation;

3. Operational philosophy

1. What is the current operational philosophy of the General Freight Business in the context of rolling stock and how will it change during or after the acquisition of the rolling stock identified in the MDS programme if at all?
2. Before acquisition what can be done through efficiency gains to improve the performance of rolling stock particularly in the GFB business.
3. Identify opportunities for private sector participation in the current market. How will they be addressed by the MDS acquisition programme? These should be discussed in the context of operational philosophy and funding.
4. What is the trade-off between the acquisition of rolling stock and locomotives with respect to improvements in efficiency of the existing fleet, Private sector participation in rolling stock and fixed infrastructure solutions such as consolidation terminals? How does this impact on the quantum of investment required to achieve the desired customer service levels and volumes over the MDS period. A sensitivity of the quantum of investment should be discussed given the various trade-offs. A quantitative and qualitative analysis should be provided here.
5. What plan has Transnet put in place to ensure that the new acquisitions are seamlessly absorbed into its operations? Consideration must be given to training, re-allocation of existing assets, maintenance facilities and capability, etc.

4. Life Cycle Costs

It is critical that Transnet procures so as to enhance the enterprise life cycle value of capital assets procured. In doing so, the objective must be to get the best value for money. Lowest capital cost can translate into very high life cycle costs and opportunity costs. Hence, lowest price is not necessarily the cheapest option. In the case of the rolling stock acquisition – best value for money could mean a net present value of the lifetime revenues from the locomotive (based on the income per ton of a standard commodity) minus the capital and operational costs of the locomotive using a discount factor based on reliability risk.

1. How does Transnet plan to optimise the enterprise life cycle value of the rolling stock to be procured?

5. Standardisation of technology (Diesels vs. Electrics)

Higher standardisation leads to larger demand and lower life cycle costs through inter-operability, lower maintenance costs and less specialised skills. In addition, the standardisation of components across locomotive technologies increases economies of scale for manufacturing and operations.

1. What is Transnet's plan for standardisation in the rolling stock acquisition?

6. Role of Transnet Rail Engineering

While it is recognised that Transnet Rail Engineering (TRE) has a role to play in the manufacturing of locomotives and wagons, there are a number of potential problems that may arise if this role is not clearly defined and rigorously managed, and this may impact negatively on the procurement.

In that regard, the PFMA application must include Transnet's response to the following in respect of the rolling stock procurement:

1. A clear definition of the scope of TRE's involvement in the rail manufacturing value chain;
2. The policies and processes that will be followed to ensure that if TRE is involved in a competitive tender, it does not prejudice competitors to TRE in the private sector;
3. The mechanisms that will be used to ensure that the cost of TRE's services are competitive, particularly when no competitive tender process is followed;
4. The mechanisms that will be used to ensure a level playing field with the private sector regarding contractual penalties and how accountability by both TRE and Transnet Group Management will be enforced should TRE fail to deliver on its contractual obligations;
5. A mechanism to ensure that the maintenance of locomotives not assembled by TRE will receive fair treatment by TRE or through the introduction of a different maintenance provider.

7. Supplier Development Strategy

It is imperative that the rolling stock acquisition is linked directly to Transnet's Supplier Development Plan. Consequently, Transnet must identify specific commodities within the rolling stock industry for which the local supply could be

increased and it must provide a coherent plan with targets for increasing the competitiveness, capacity and capability of this local supply base. Consideration must be given to how suppliers will be managed and should include a range of incentives and penalties for performance along the entire supply chain.

8. Socio Economic Objectives

It is critical to integrate supplier development and BBBEE concerns into every step of the sourcing process from requirement definition through to contract close-out in order to optimise the many synergies between commercial, supplier development and transformation objectives.

Consequently, Transnet must provide the Shareholder with a plan of how supplier development considerations will be integrated throughout the sourcing cycle for the rolling stock acquisition.

1. How will the procurement drive industrialization, job creation, localization, skills development and transformation? What is the plan and associated targets in this regard?
2. What initiatives are being taken to enforce high levels of supplier effort – ie. That the suppliers continuously improve on their performance and lower costs based on their learning curves?
3. From an industrialisation perspective, consideration must be given to the capability and capacity of the domestic locomotive manufacturing & service industry to "absorb" a technology. Is Transnet taking into account the following areas in their supplier development evaluation criteria:

    a) Local content as % of total content through time;
    b) Value of the procurement spent in SA as % of total value through time;
    c) Investment in plant by suppliers;
    d) Technology transfers;
    e) Skills development;
    f) OEM sub-contractor development programs;
    g) OEM and big sub-contractor small business development programs;
    h) Export promotion / offsets.

9. Risk Management

1. Please provide a risk management strategy specifically relating to the risks associated with particularly the length and scale of the procurement.

10. Financial Analysis

The financial models must be provided in Excel format and included in the data CD. The excel financial model must also include all calculations so that the department can conclude its analysis without reverting to Transnet for more information

1. A detailed financial model addressing the standard requirements for incremental capital expenditure;
2. The price sensitivity (tariff) of each commodity provided on an annual basis. The department wishes to understand the impact of CAPEX on tariffs;
3. The volume sensitivity of each commodity provided on an annual basis and at an aggregate level on an annual basis;
4. The impact of total price sensitivity and volume sensitivity on the financial model and financial indicators in bullet 1 above;
5. Provide linkages to all relevant Shareholder Compact indicators over the MDS period including:
   a. ROA;
   b. Volumes;
   c. Asset utilisation;
   d. Service reliability;
   e. Turnaround and cycle times;
   f. Reliability and availability (TRE);

11. Shareholder Support

1. Kindly specify the Shareholder support that may be required for the successful implementation of the rolling stock procurement programme?

MINISTER: FINANCE
REPUBLIC OF SOUTH AFRICA

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PO Box 29, Cape Town, 8000, Tel: +27 21 464 6100, Fax: +27 21 461 2934

Ref. M4/1/20 (921/14)

Mr Mafika Mkwanazi
Chairperson of the Board
Transnet SOC Ltd
P O Box 72501
PARKVIEW
2122

Dear Mr Mkwanazi

TRANSNET'S APPLICATION IN TERMS OF SECTION 54(2)(d) OF THE PUBLIC FINANCE MANAGEMENT ACT FOR THE ACQUISITION OF 100 DUAL VOLTAGE LOCOMOTIVES FOR THE EXPORT COAL LINE

I refer to your letter dated 10 April 2014 with regards to the abovementioned matter.

I note Transnet's intention to acquire 100 dual voltage electric locomotives for the Coal Export Line at an estimated cost of R4.8 billion. I understand that this acquisition will release 125 locomotives from the Export Coal Line to the General Freight Business (GFB) to mitigate against possible volume and revenue deficits due to the delay in the 1064 GFB locomotive tender process.

However, Transnet's submission has limited information on the procurement strategy to be adopted. The National Treasury requires reassurance that Transnet's preferred accelerated confinement procurement method was the most appropriate strategy given the circumstances. In order to establish this, Transnet must disclose the alternate suppliers that were considered and evidence of how and why China South Rail (CSR) was selected as the preferred supplier. In addition, the following information would be helpful to provide assurance that the proposed procurement strategy complies with all legislative requirements:

1. Comprehensive analysis of the five procurement options considered by Transnet (Go out to tender, Do nothing, Confine, Extend the current 20E contract for 95 CSR locomotives, and leasing);

2. Detailed evidence on how the confinement method was selected as the preferred option;

3. Details of Transnet's current contract with CSR with emphasis on its compliance with legislative requirements such as the Preferential Procurement Regulations and the National Industrial Participation Programme; and

4. Risk management plan to mitigate against all possible risks that may derail the project.

I look forward to your assistance in providing the required information to enable an informed decision to be reached regarding the acquisition of the locomotives.

I trust that you will find the above to be in order.

Yours sincerely

NHLANHLA M NENE, MP
MINISTER OF FINANCE
DATE: 29/9/2014

cc Ms L Brown, MP
Minister of Public Enterprises

TRANSNET

Linda Mabaso, Chairperson

Our Ref No: LM/18192

Mr Nhlanhla Nene, MP
Minister of Finance
Private Bag X115
PRETORIA
0001

Fax: 012 315 5126

Dear Minister Nene

Ref M4/1/20 (921/14): TRANSNET'S ACQUISITION OF 100 DUAL VOLTAGE LOCOMOTIVES FOR THE EXPORT COAL LINE

Your letter with the above reference dated 29 September 2014 was received by Transnet and Transnet welcomes your correspondence in relation to the above transaction.

This letter seeks to respond to the queries raised in your letter and provide some level of assurance that the thinking applied before entering into the transaction to acquire the locomotives is in accordance with the highest level of governance. It should be noted that the acquisition is fully aligned to the strategic direction of the Company as the investment is included in the Market Demand Strategy arising from a business need.

'1. Comprehensive analysis of five procurement options considered...'

Delays were experienced in the tender process for the acquisition of the 1064 locomotives due to the following:

- Aggressive timelines built into the tender, resulted in requests for extensions and clarifications.
- Process to obtain PPPFA exemption was lengthy and complicated
- Evaluation basis could only be made available to bidders after exemption from PPPFA was obtained
- Evaluation of bids could only commence after PPPFA exemption was obtained
- The extensions and clarifications requested above had to be adequately addressed with timeline extensions granted as a challenge to the award would impact award of the contract
- Transnet's appetite for a legal risk and challenge of the award is minimal given the tractive capacity requirements, we believe that the extended tender process mitigates the legal and challenge of award risk.

The business need was first established which basically looked at the situation with the tender process for the acquisition of 1064 locomotives for Freight Rail's General Freight Business (GFB). GFB volumes were at risk and the main reason for this was a shortfall in tractive capacity. The fastest way to bring tractive capacity into the system given the constraints in GFB is to accelerate the acquisition of locomotives planned for the Coal Line.

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This would free up existing locomotives on the Coal Line to service the GFB sector as an interim measure until the 1064 contracts commence delivery. The cascaded locomotives from the Coal Line will then be retired as the locomotives from the contracts of the 1064 are brought into service. The 100 locomotives for the Coal Line are part of the fleet plan and 7 year capital investment plan and were being accelerated, it is not an addition to the fleet plan but an acceleration of the investment.
The critical issue in this instance was one of timing, basically fast tracking the introduction of tractive capacity to mitigate against MDS volume risk in the short to medium term.
The 1064 locomotive tender process was conducted at the same time, indicating that Transnet had the benefit of recent submissions from suppliers for purposes of comparison and improving our negotiating position.
There have been no objections or challenges raised to date thus no risk pertaining to commencement of production of the locomotives as all suppliers have accepted the decision.
With timing being of crucial importance, the options considered were carefully explored, however once a particular option was explored and proven to be unviable to address the above crucial need, it was discarded without any further analytics being performed.

- Do nothing: This would clearly not address the business needs as volume risk would still exist.
- Go out on open tender: This approach would take considerable time to execute just the tender process. The objective of bringing tractive power on as soon as possible to mitigate short to medium term MDS volume risk would not be met. This option was thus discarded due to the timeline constraint.
- Extend current 20E contract for the 95 locomotive acquisition: The major reason for not extending the 95 contract is that the locomotives for the Coal Line are of a different specification. Locomotive specification is a key component of any locomotive manufacturing contract. Changing specifications on an existing contract will create significant complications and potentially a contract on which the terms and conditions are not enforceable. The process followed for this acquisition was an open tender process and extending the current contract would result in a material amendment such that we may need to go out on tender again as losing bidders could challenge that their bids would have been different had they known about the final quantum of locomotives and possibly resulted in them winning the tender.
- Leasing: The option to lease locomotives was explored. The locomotives to be leased are small in quantity and 30 years old and would not address business need. The impact of leasing the locomotives will be minimal.
- Confinement to China South Rail (CSR) which is the chosen option was embarked upon due to the following:
    - Urgency of the process to acquire locomotives to satisfy tractive power requirements
    - Locomotives are known as CSR are currently manufacturing the 95 locomotive contract which is progressing well from a quality and reliability perspective.
    - CSR have produced the fastest prototype and delivery of the first locomotive within 6 months of completing the design freeze.
    - CSR has production facilities in China that can produce 2000 locomotives per

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annum and can produce locomotives with immediate effect With the 95 locomotives currently being built by CSR, they have the learning curve benefits in terms of the production process.

- CSR is a known supplier of locomotives and they have performed well on the last two tenders for electric locomotives (95 and 599/1064) in terms of:
  - Technical capability
  - Capacity to deliver the required product
  - Supplier development
  - Commercial and
  - Transformation
- Confinement to CSR meets the criteria for confinement as set out by the Board of Directors.

'2. Detailed evidence on how the confinement method was selected as the preferred option'

There are basically two approval hurdles for confining a procurement event:

1. In terms of the Delegations of Authority, confinement of Tenders to a value exceeding R1 billion may only be approved by the Transnet Board of Directors
2. In terms of the PPM, confinement of tenders may only be approved under the following circumstances:
   a. Where a genuine unforeseeable urgency has arisen. Such urgency should not be attributable to a lack of planning, however where an urgency has arisen due to a lack of planning urgency can be relied upon as grounds for confinement. In such case action must be taken against individual(s) responsible for the bad planning.
   b. The goods/services are obtainable from one or limited suppliers for instance patented/proprietary goods or OEM spares and components. Operating Divisions are however required to provide evidence that there are no new entrants to the market who could also be approached.
   c. For reasons of compatibility and standardisation of existing goods and services. A case must be made that deviation from existing standardised goods and services will cause major disruption. If not, confinements based on standardisation will not be considered.
   d. When goods or services being procured are highly specialized and largely identical to those previously executed by that supplier and it is not in the interest of the public or the organisation to solicit other offers, as it would result in wasted money and/or time for Transnet. When this particular ground is intended to be used as a ground for confinement, it is important to note that all pre-requisites must be satisfied:
      i. The goods or services must be highly specialized
      ii. Almost identical to previous work done and
      iii. Approaching the market again would result in wasted money and time

With the above framework in place the conditions applicable for the transaction to meet the criteria for confinement is detailed as follows:
Paragraph (a) is applicable in this instance as a genuine unforeseeable urgency has arisen. The timelines for the tender process for the acquisition of 1064 locomotives were not realistic. Certain delays were encountered which resulted in timelines moving out. These delays include:

- Development of the business case to obtain first time approval from all approval gates (Transnet Exco, Board Acquisitions and Disposals Committee, Board of Directors and Shareholder Minister).
- The tender for the locomotives is large and complicated and with aggressive timelines built into the tender there were requests for extensions and clarifications.
- The process to obtain PPPFA exemption was lengthy and complicated and:
  - Bids could only be evaluated after obtaining PPPFA exemption
  - The evaluation basis could only be made available to bidders after PPPFA exemption was obtained.
- The extensions and clarifications mentioned above would have to be adequately addressed with timeline extensions granted as a challenge to the award would impact the award of the contract.

As evidenced above the delay experienced on the 1064 tender process is not attributable to poor planning by an individual or group of individuals.

Complementing "ground (a) – urgency" for confining a tender are grounds (b) – limited number of suppliers, (c) - standardisation and (d) goods are largely identical to those previously executed.

- (b) Locomotives are highly specialized with only a few suppliers worldwide.
- (c) There are currently 21 different locomotive models in the fleet. This places unnecessary operational complexities and cost burdens in terms of driver deployment and utilisation, spares holding, strategic spares holding and maintenance facilities and practices. The locomotives are largely the same as currently being procured on the acquisition of 95 locomotives contract, a significant level of standardisation can be achieved through confinement.
- (d) Locomotives by their nature are highly specialized and the 100 Coal Line locomotives are essentially similar to those already being acquired (95 locomotives). In addition, Transnet would incur wasted time and money in approaching the market due to the following:
  - CSR has been identified as the best bidder during the open tender process to appoint a contractor for manufacture of the 95 locomotives
  - Both these tenders (95 and 100) include Board approved procurement methodology for maximizing supplier development, whilst ensuring the highest quality standards and commercial offering.
  - Transnet has recently invested a large amount of time, human capital and money in evaluating the tenders and going through another tender process would not be efficient given the urgency required from a traction capacity perspective.
  - The Mitsui contract which has been recently completed was embarked on

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where criteria such as supplier development were not a key focus area. As a result Mitsui did not fare well in the most recent tenders issued by Transnet.

- Confining the contract to Mitsui would result in them having a monopoly for the supply of locomotives to the Coal Line. Transnet found this concentration risk unacceptable as the downstream impact in terms of cost of spares, strategic spares and tooling would place Transnet in a vulnerable position.

The decision to confine has been justified through paragraph (a) of the grounds for confinement contained in the PPM, however the table below provides a high-level summary of the other grounds that further enhance the decision to confine:

Ground	(a)	(b)	(c)	(d)	✓
	✓	✓	✓	(i)	✓
				(ii)	✓
				(iii)	✓

'3. Details of Transnet's current contract with CSR with emphasis on compliance with legislative requirements'

The PPPFA was followed and the 90/10 rule applied.

Supplier development commitments contained in the contract currently in production (95 electric locomotives for GFB) are as follows:

Category	Amount
Total	R1787m (65% contract value)
Actual to March 2014	R441m
Broken down as follows:	
Localisation	R163,4m
Skills Development	R46,9m
Investment Plan	R92,0m
Industrialisation	R136,2m
Small Business	R0,1m
Rural Development	R2,6m

'4. Risk Management plan to mitigate against all possible risks that may derail the project'

The acquisition of 100 locomotives is in itself a risk mitigation plan against the interim volume shortfall of the MDS over the next two years due to delayed delivery on the 1064 locomotive acquisition. A risk mitigation plan has been developed for the acquisition of 1064 locomotives for GFB. This plan was developed with the entire locomotive acquisition programme in mind which includes:

- 95 GFB electric locomotives,
- 1064 GFB locomotives,

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- 100 Coal Line electric locomotives and
- 60 GE diesel locomotives.

The risk mitigation plan developed for the 1064 locomotives is thus applicable to the 100 Coal Line locomotives and is the worst case scenario eg. All risks have been rated as Level 1 (highest priority, red, considered by Board and Exco and action plans are to be developed and effected within 6 months of the risk being identified), however rail infrastructure risk on the Coal Line is not high as the GFB network. The risk plan at a high level covers the following risks:

1. Delivery delay
2. Rail Infrastructure
3. Energy supply
4. Market
5. Customer
6. Operational readiness
7. Financial
8. Production
9. Infrastructure
10. Logistical
11. Human capital
12. Technology
13. Material
14. Security
15. Compliance
16. Project management
17. Safety, health and environment
18. Quality management

As is evident from the above list, a comprehensive plan was developed and is attached as Annexure A.

Engagement workshops were held with the DPE together with National Treasury on the PFMA application to acquire 100 Locomotives for the Coal Line. A summary of the notes is provided (Annexure B) for your ease of reference. The notes were circulated in response to queries raised by the Minister in the letter of approval of the investment. It was unfortunately not copied to the National Treasury.

"Informed decision to be reached regarding the acquisition of the locomotives"

The request to acquire the locomotives was approved by the Minister of Public Enterprises on 23 May2014. Approval letter from the Minister of Public Enterprises attached as Annexure C.

Kindly note that in November 2011 a request in terms of the PFMA was mistakenly made to both the DPE and National Treasury, Transnet were duly informed that approval of the

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Investment is not part of the National Treasury's responsibility (letter from the Minister of Finance attached as Annexure D) but that of the Shareholder Minister. This is a correct interpretation of the PFMA and National Treasury is required to be informed of the transaction. This has been Transnet's approach since (request approval from the DPE and notify National Treasury).

In the interests of information sharing and integration, both the DPE and National Treasury representatives are invited to all engagements relating to section 54 PFMA applications and quarterly reporting on progress of the infrastructure rollout plan. These joint engagements have been working well with good cooperation between the various Departments and Transnet.

The acquisition of the 100 locomotives for the Coal Line has been accelerated. Delivery of the 100 Coal Line locomotives has commenced with 14 locomotives having been delivered by mid- February 2015. These locomotives are in various phases of testing at the OEM's and TFR's premises.

I trust that the response provided together with annexures gives you an acceptable level of assurance that the transaction entered into subscribes to the highest standards of governance and complies with all legislative requirements.

Please do not hesitate to contact my office should you require further clarity on any matter relating to the acquisition of 100 locomotives for the Coal Line.

Kind regards

Linda Mabaso
Chairperson
Date: 31/03/2015
CC: Ms L Brown, MP
Minister of Public Enterprises

798

Annexure A

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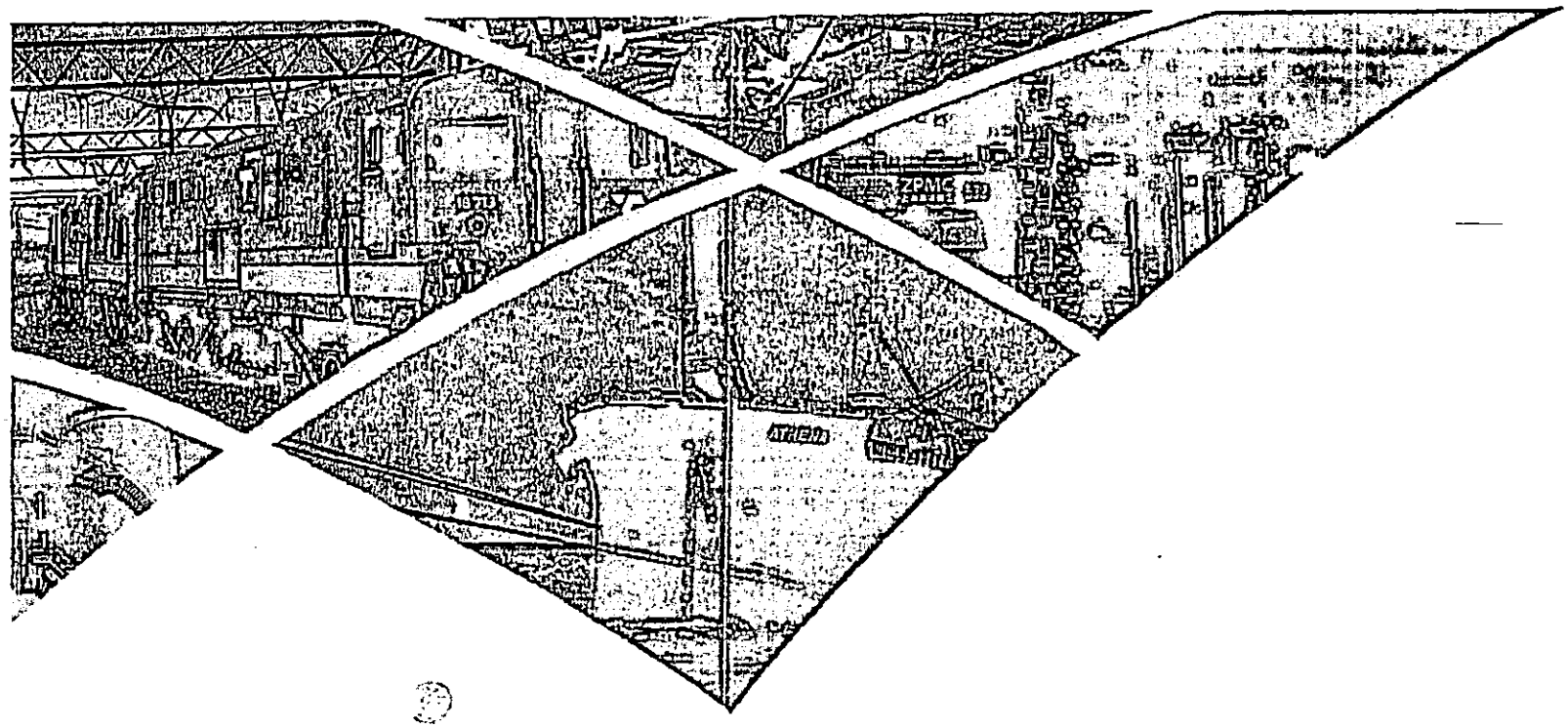
delivering freight reliably



Acquisition of 1064 locomotives for TFR's General Freight Business: Risk Management Plan

19 September 2014

20 YEARS OF FREEDOM

Background – Accelerated Loco Delivery and Associated Business Impacts

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Risk Assessment Context

During the workshops the following principles were considered:

- The assessment was limited to the identification of the locomotive delivery risks and mitigation strategies.
- The relationship between rail infrastructure and rolling stock was considered in the risk assessments.
- Issues relating to Opex/Capex affordability were considered.
- TE is part responsible (as sub-contractor) for the building of the locomotives and contracting with the OEM (as lead). The contractual relationship for the delivery of the locomotives is therefore between TFR and the OEM.
- TE, in the capacity as landlord, is providing the production facilities to the various OEMs.
- Customers are not investing at the same rate as anticipated, which could lead to delayed benefit realisation.
- Order of magnitude of delivering the 1064 locomotives and the organisational change needed should not be underestimated.

Risk Excluded from the Assessment

Post-productions risks such as maintenance, redundant equipment and production facilities, were not included in the assessment.

Risk Rating

It was an unanimous decision that all risks should be treated as Level I risks and be treated as stipulated in the Transnet ERM Methodology.

800

Business Risks: Level 1

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Risk	Risk Description	Mitigating actions
Loco Delivery Delay Risk	▪ OEM's / Sub-contractors unable to meet contract delivery commitment ▪ Capacity and capability constraints	▪ OEMs and subcontractors to finalise the subcontractors agreement ▪ Locomotive governance steering committee to provide oversight on the adherence to delivery milestones ▪ Continuous engagement between OEMs and TFR regarding delivery progress ▪ Suppliers/ subcontractors to escalate issues relating to late delivery immediately to TFR ▪ Vigorous contract management ▪ Should locomotive delivery be delayed, subsequent run-out of the old fleet will also be delayed (increased maintenance costs and possible locomotive failures) ▪ Structured quality inspection programme to be undertaken by TFR
Rail Infrastructure Risk	▪ New locomotives will be traversing fatigued rail infrastructure ▪ Infrastructure failure remain/deteriorates which will lead to operational disruptions ▪ Affordability of Capex, Copex and Opex ▪ RSR technical standards threatens TFR licencing conditions and penalties	▪ Continuation and improvement of rail network Copex, Opex and sustaining Capex programmes ▪ Achieve of "A" standard network to match locomotive requirements (as dictated by the RSR) ▪ Submission of business case to Capic (Nov 2014) to ensure "A" standard rail infrastructure ▪ Selective investment based on high yield commodity corridors ▪ Developing scenarios to consider various affordability options
Energy Supply Risk	▪ Inherent risk of Eskom power interruptions impacting tonnage delivery	▪ Explore alternative power generation initiatives (medium to long term option)

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Business Risks: Level 1

Risk	Risk Description	Mitigating actions
Market Risk	▪ Customer readiness for rail ▪ Low economic growth/ contraction ▪ Volatile / uncertain demand from Eskom ▪ Fluctuating mining commodities' pricing impacting demand – also from Botswana	▪ Aggressive marketing of TFR's product offerings ▪ Annual volume validation with customers ▪ Written commitment and confirmation from customers ▪ Implementation of take or pay contracts for Mega Rail customers ▪ Explore contractual alternatives to limit the risk exposure of investments made for customers who do not meet volume commitments ▪ Implementation of aggressive New Road to Rail strategy and opportunities identification
[illegible]	▪ Total logistics chain, address customers' ability to deal with increased freight – siding and loading equipment / facilities	▪ Identification of key customer constraints ▪ Customer engagement to explore solutions to effectively address loading and offloading facilities availability and reliability
[illegible]	▪ TCP, TE, TPT and Rail Network capacity to execute projects supporting the locomotive deployment. ▪ Acceptance testing readiness ▪ Driver training and readiness ▪ Infrastructure material supply & transport – transporting long rails ▪ Material availability – e.g. supply of rail, ballast, sleepers etc.	▪ Integrated capital project planning between TCP, TE, TPT and Rail Network to ensure alignment across the value chain ▪ Operational readiness plans have been effected in preparation for the locomotive deployment (e.g. training of train drivers and maintenance staff; acquisition of upfront spares , tools and facilities) ▪ Orders for the procurement of railway material done a year in advance. ▪ Locomotive execution strategy - four tier governance structure (Executive Sponsor, Steering committee, Locomotive Owners team, Programme Director) ▪ Establishment of a Programme Management Office

802

Business Risks: Level 1

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Risk	Risk Description	Mitigating actions
Financial Risks	▪ Non-payment or delays in payment to TE by the appointed OEMs ▪ Termination of the contract by OEM's ▪ Increase in the Project Input Cost (energy, electricity, security, steel and etc.) ▪ Corruption, fraud and other forms of criminality	▪ Existing Finance procedures and processes ▪ Project Steering Committee ▪ Regular project meetings ▪ Daily production meetings ▪ In-line/hold point inspections for detecting defects earlier ▪ Energy saving initiatives ▪ Ongoing review of security measures ▪ Fraud risk strategy ▪ Systems controls – Procurement and Finance
Production Risk	▪ Inability to ensure a timeous manufacturing of the required Locomotives as scheduled	▪ Project plan ▪ Daily production meetings aimed at tracking progress ▪ Adequate Human Resource Allocation ▪ Financial Commitment
Infrastructure Risk	▪ Energy supply - load shedding ▪ Inadequate machinery and equipment capacity to ensure successful completion of the project ▪ Delay in the establishment/purchase of the required Facilities/Equipment for the project	▪ Electricity backup systems (e.g. generators) ▪ Maintenance plans across TE operations ▪ Prioritisation of Capex list ▪ In-house modifications ▪ Capex approval processes
Logistical Risks	▪ Logistical and warehousing constraints ▪ Shipment and transportation logistics constrain ▪ Non conforming material for components and reverse logistics	▪ Logistics Management Strategy for 1064 ▪ Dedicated logistics human resources ▪ Dedicated warehouse for 1064 scope ▪ Inspection of material on arrival ▪ Project Steering Committee

Information provided by TE

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Business Risks: Level 1

Risk	Risk Description	Mitigating actions
Human capital risks	▪ Insufficient human capacity to meet the production and maintenance demand (competing national rail projects) ▪ Limited technical human capacity from OEM ▪ Industrial action ▪ Incompatible working practices between TE and OEM's	▪ Feeder channel of apprenticeships ▪ Usage of experienced planners ▪ Making use of fixed term contractors ▪ Training agreements with OEMs ▪ Strike management committee ▪ Change Management Strategy (e.g. communication strategy)
Technology risks	▪ Technological challenges - none or ineffective involvement of TE in the technology discussions and conclusions between the appointed OEMs and TFR ▪ Lack of TE's knowledge on the proposed system and the infrastructure requirements ▪ Systems incompatibility (Oracle vs SAP) ▪ MRP and OEMP integration	▪ Drawing and design freeze ▪ More controls to be developed to manage the risk ▪ Existing ICT Processes and Procedures
Material risks	▪ Ineffective Bill Of Material (BOM) Change Control ▪ Delays in finalisation of the design freeze ▪ Material delay and unavailability (due to non-availability and accuracy of BOM) ▪ Ineffective management of the existing suppliers ▪ Third Party Performance Risks - dependency on the performance of a third party	▪ Timeous placement of Purchase Orders ▪ Weekly localisation meetings ▪ Usage of developed suppliers ▪ Institute penalties for non-delivery ▪ Change control (TE and OEMs) ▪ Contracts with service level agreements ▪ Non-conformance procedures (for third party service providers) ▪ Daily tracking of progress within TE

Information provided by TE

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Business Risks: Level 1

Risk	Risk Description	Mitigating actions
Security Risks	▪ Ineffective Security Management ▪ Theft of the OEMs' IPs	▪ Existing Security Plan and Procedures in place ▪ SHE Induction ▪ Usage of different Bays and Centres for each OEM ▪ Existing ICT security measures in place
Compliance	▪ Not meeting Supply Development and Localisation targets ▪ Ineffective document management	▪ Regular Project Meeting ▪ Contract between TE and OEMs ▪ Supply Development Strategy ▪ Supply Development Summit
Project Management	▪ Ineffective Project Management of the 1064 scope of work	▪ Daily Project Meetings ▪ Regular Project Meeting ▪ Project Steering Committee ▪ Appointed Project Coordinator at the GM's Level
SHE Risks	▪ Increase in injuries/fatalities and disabilities ▪ Non compliance to contractor SHE requirements by the OEMs ▪ Utilisation of unknown hazardous chemical substances (such as asbestos) ▪ Business Interruption	▪ SHE policies, processes and procedures in place ▪ SHE Induction ▪ Plan Job Observations ▪ TE SHE contractor specifications ▪ OEM SHE requirements presentation at the Scoping Sessions ▪ Approval of hazardous chemical substances ▪ Training and Awareness on the Material Safety Data Sheet (MSDS) ▪ Medical surveillance programme ▪ Business Continuity Plans

Information provided by TE

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Business Risks: Level 1

Risk	Risk Description	Mitigating actions
Quality Management Risk	▪ Delivery of inferior products (i.e. defects, poor quality)	▪ Change Control Board in place ▪ Regular Production Meetings ▪ In-line inspections and internal audits to ensure compliance to SOP ▪ Supplier audits and incoming material inspections ▪ Audits, quality control plan, Quality Management Framework ▪ Inspections conducted as per customer request

Information provided by TE

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Action Plans – Accelerated Loco delivery and associated business impacts

Issue	Action Owners
Contract management risk assessment based on the analysis of contract conditions	Group and OD Legal, Group, TE & TFR Risk
Establish governance steering committee at Group level.	Chief Risk Officer
Acid test of rail replacement business case	TFR & Group Finance
Reputational risk should be proactively managed including stakeholder engagements and communication especially with the media. Full involvement of Group Communications is required	Group Communications, TE & TFR Risk
Quantification of funding alternatives	Group Finance
Operational readiness plan to be shared with Group Risk (Completed)	TFR Capital Program Office
Insurance management (integrated approach) to be finalised (Completed)	Group Insurance
Change Management between TFR and OEMs to be formalised	TFR COO
Design freeze to be implemented timeously to provide sufficient time for Supplier Development	TFR/TE COO
Decision on the allocation of production facilities between Koedoespoort and Durban to be finalised	TFR/TE COO

Annexure B

Engagement with DPE and National Treasury on 23 May 2014

No.	Item	Response
1	What do Transnet mean when we say contract in execution?	The contract is in progress and can be reversed if approval is not obtained.
2	What are the types of freight and the routes on which they will be transported?	This is well documented in the 2014/15 corporate Plan. Primarily the freight targeted is: • Manganese • Domestic Coal • Mining minerals • Intermodal (containers and automobiles) • Road to rail shift
3	What is the deployment plan and the impact of the deployment on volumes	This will only be available as the locomotives are deployed onto the network and the associated impact on volumes will be recorded once the locomotives are in operation. In order to measure full impact the locomotives would need to be operational for a full year as all volume commitments are quoted in annual quantities. Monthly extrapolations can be determined.
4	Why did Transnet not confine the acquisition to two suppliers	Tractive effort is the key constraint impacting volumes. TFR needs to grow faster than the commitment to volumes in plan. The shortfall in tractive capacity needs to be augmented. In executing the 1064 tender process around December 2013, Transnet had the benefit of observing the progress in terms of: • Which tenderers were providing the most value • The various competitors bidding • CSDP offerings of the various tenderers Transnet did not want to place ourselves in a position where Mitsui became a monopoly for the supply of locomotives to the Coal Line, Mitsui would be supplying 210 locomotives to the Coal Line if awarded the tender. Initial capital outlay constitutes about a third of the total cost of ownership. Allowing Mitsui to be the monopoly supplier will impact the long term cost on the Coal line. Transnet would be in a 'sitting duck' position if this was allowed.
5	Delivery on SD against existing contracts. Provide a report on the performance.	GE have produced an SD report as it relates to the acquisition of 143 locomotives that have recently been built and supplied to TFR. A portion of the report (Annexure B1) is attached for your ease of reference.
6	Provide specifics as it relates to the 70% localisation mentioned in the submission	The specifics are part of the negotiations currently underway and will be provided once agreed to and finalised.
7	Was the PPPFA followed when determining the tender specifications for this contract?	Yes. Transnet applied the 90/10 rule
8	What are the SD obligations on the 95 CSR locomotives	Overall SD obligation is R1787m (65% of contract value). Actual SD to March 2014: R441m • Localisation (R163,4m)

Annexure B

No.	Item	Response
		• Skills development (R46,91m) • Investment Plan (R92,03m) • Industrialisation (R136,21m) • Small business (R0,14m) • Rural development (R2,58m)
9	What measures have Transnet put in place to ensure delivery against local content?	There are various measures in place which include: • Plans need to be submitted between 90-120 days after contract sign off by the awarded tenderers • Non-submission of the requisite plans is grounds for termination • Inclusion of SD penalty clauses are included in the contracts • Obtaining an SD bond to cover default risk • Appointment of Socio-Economic monitors to provide assurance around the performance against planned SD commitments. • Transnet Engineering is the appointed local assembler
10	Apart from concentration risk by utilising one supplier what are the other risks/issues relating to the appointment of one supplier?	Standardisation. The fleet currently consists of 21 different locomotive models which negatively impacts costs in terms of: • Spares holding and specialist tools for each locomotive model • Infrastructure • Operational issues • Driver certification. Driver certification of competency for each model • Training regimes • Maintenance in terms of engineering skills requirements and fault diagnosis for each locomotive model CSDP benefits are considerably greater than if the 1064 contract was awarded to a single contractor The 1064 contract as mitigated as it relates to: • Delivery • CSDP • Business could not wait for the schedule as per the 2013/14 Corporate Plan as that would severely impact volume throughput • The cost of the 1064 acquisition would be between R60 and R65 billion if the original delivery schedule was adopted as we would be hedging over a 2-3 year longer period. • GE and CSR are not considered risky as their track record has been established and their products are working well in our operations. CNR and BT although not considered risky are untested in our operations

Annexure B

No.	Item	Response
		and will be appropriately mitigated 2 suppliers are considered ideal for each of the diesel and electric components of the 1064 acquisition. High enough to mitigate concentration risk and low enough to obtain maximum CSDP benefits. 3 suppliers each for electric and diesel locomotives would dilute CSDP benefits and render Transnet unable to take advantage of economies of scale. This will also drive up the locomotive cost per unit.
11	What do the Socio Economic monitors do?	After the Gautrain was completed, Transnet engagement with their management to assist Transnet in addressing the matter of monitoring the socio economic initiatives on the project and determining if objectives were met. Arising out of that discussion was the appointment of SEMs who provide an assurance role through assessing the achievements against initiatives provided in the plan. This will enable Transnet to report on socio economic activities of the project.
12	The suppliers are aware of Transnet's acute need for tractive capacity and would not be fearful of a termination clause as it was unlikely to be enacted	On the contrary, Transnet will not hesitate to terminate a contract where it is warranted. Termination is a last resort after all avenues to ensure performance have been exhausted. Locomotive suppliers are in the business of manufacturing locomotives and it's not in their interest for their contracts to be terminated as this affects reputation in a massive way. The OEMs see this contract as their gateway into Africa. This contract is therefore given their utmost efforts as it is an opportunity for them to make a first impression. OEMs have thus far been enjoying a free partnership with TE which enabled them to enjoy super profits while TE earned a small margin. Transnet is exploring the option of co-operation agreements and a profit sharing model. In conjunction with the PWC work conducted between the DPE and Transnet it has been established the OEMs are protective over their Intellectual Property. In line with the Minister's vision, TE wants to move into the OEM space from a strategic perspective and Transnet is confident that with the combined scope of the various localisation initiatives with each of the contractors, we are in a position to complete the basket of becoming an OEM. OEMs sub-contracting to TE have established a concrete relationship and launch pad for their expansion into Africa. Suppliers like EMD need to re-examine their strategic positioning in Africa as they are currently not getting much work outside of the USA.
13	Provide clarity on the delays relating to	Transnet's initial approach as it relates to timelines for the tender process was not realistic. The 1064 tender is large and

Annexure B

No.	Item	Response
		ability to generate cash. Funders will advance funds to Transnet based on its cash generating ability.
23	There seems to be problems with the MDS, should DPE be concerned?	If the 100 and 1064 locomotives are not delivered timeously then Transnet will be in trouble. The next 24 months will define Transnet's history and success. There are delivery risks as it relates to the awarding of the tender. No concern as the plan is realistic and do-able. The most significant factor is however tractive effort. We have re-baselined volumes and have instituted active plans in terms of cash realisation. OEMs are very much committed to delivery. The diesel locomotives are not very different to those already produced. The 100 locomotives for the Coal Line is not very different to the 95 CSR Dual Voltage Electrics currently in production. Transnet has a plan in place to manage China North Railway and Bombardier Transport to ensure that delivery is as contracted.
24	Diesel versus Electric. How is the split determined?	The configuration of the infrastructure is a key determinant. Non-electrified lines may only operate diesel type locomotives. Demand on this section of the network will determine the quantity of locomotives. A slide of the network is provided in addition.
25	Coal expansion to 81mt, how were the mine plans determined and timing of Transnet capacity?	The 81mt expansion is already secured by 'take or pay' contracts. Expansion to 97mt is dependent on mine plans and will be firmed up through a commercial validation process. As indicated earlier, water and electricity are the potential constraints to the Waterberg expansion. A planning process is being undertaken to determine when capital is being deployed. Capital will not be removed from the plan but deferred.
26	If urgency was not an issue who would be the preferred bidder?	An open tender process would have been followed and the outcome of that process would determine the preferred bidder.
27	DPE need to find a sense of comfort. Is TE in a position to take up given the urgency?	The 1064 process gives effect to the Minister's vision incorporated in the study. The 100 locomotive contract consists of basic work and similar to the type of work done in the past. A high level scope of the TE work will be submitted to Transnet's Board Acquisition and Disposals Committee in June 2014. CSDP plans will be shared as well.

MINISTER
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Chairman
Transnet SOC limited
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Dear Mr. Mkwanazi

Application to the Shareholder Minister in terms of the Public Finance Management Act (PFMA) for the acquisition of 100 dual voltage electric locomotives for the export coal line

Your application dated 10 April 2014 refers.

Whilst understanding that the Market Demand Strategy targets must be achieved by Transnet as committed, matters of concern remain existent in the latest application received in aim of mitigating the delay of the 1064 locomotives delivery.

I appreciate that this acquisition will assist in realizing a portion of the Market Demand Strategy volumes and also avoid revenue losses, thereby contributing to the road to rail migration. While volume growth and retention is the basis of the business case to acquire these additional locomotives, the

trend from previous years depicts that Transnet has consistently moved significantly lower than forecasted volumes. This therefore fuels the concern of the Department as to how realistic the assumptions are, which underpin the forecasted volume growth and therefore the capital investment programme needed to meet the assumed volume targets. While Transnet is encouraged to continue to stimulate the economy through capital investment, it remains a key focus of the Department to ensure that the capital programme is optimized and investments are made in the right areas.

In an effort to understand Transnet's rationale in the investment allocation, Transnet is requested to indicate the current capacity of the corridors in which the cascaded locomotives are expected to be deployed, as well as the reasons as to why those corridors were selected. In addition, Transnet is further requested to provide the incremental volumes expected to be derived for each of those corridors as a result of the deployment. This will assist and enable the Department to track the volume benefits of this acquisition.

Despite the benefit of increased traction capacity from additional locomotives, this project would be expected to also yield efficiency benefits. However, these benefits have not been quantified in the business case. In the absence of scientifically quantified benefits linked to the investment programme, it is almost impossible to hold Transnet accountable to deliver on efficiency improvements that are expected to be derived from the capital investment. Transnet is therefore requested to provide quantified and reliably measurable efficiency gains that should be extracted from this acquisition. This information should be provided by specific corridors or by business units as per the deployment of these locomotives.

I am also aware that post the submission of this application; there were engagement between officials of the Department and those of Transnet. As per those engagements, the following information was requested from Transnet and is still outstanding:

- Transnet was requested to supply the determined impact/total value add of the project to GDP.

- Since Transnet has already concluded the contract for this acquisition, subject to PFMA approval, I therefore request that Transnet furnish me with a copy of the agreement concluded with China South Railway (CSR) as this will provide an in depth understanding of the transaction that Transnet is entering into and enable the Department to properly assess the risks pertaining to the proposed transactions.

- Considering that the 100 locomotives was not indicated by Transnet as part of the original mitigation action for the risk of delays in the 1,064 locomotives delivery, Transnet needs provide reasons for the deviation from the initial risk mitigation plan.

- In relation to the confined procurement plan for this application; from a risk perspective the concern is the possible litigation challenges that can come from other possible suppliers, thus impacting on the project execution and delivery timelines. More information on Transnet's mitigation plan in this regard is therefore required.

- Transnet to provide further information about the types of jobs/skills to be created through this transaction. The SCC is further requested to specify how many jobs are expected to be created and retained in downstream enterprises.

- Considering that this is a R4.84 billion transaction, the closed tender process could have been looked into rather than the confinement option as this would reduce Transnet'srisk exposure to litigation challenges. Transnet is therefore requested to provide a full explanation as to why a closed tender process was not considered for this transaction.

- The business case has not provided a proper risk assessment of the project and the mitigations thereof. This would further assist in the Department's assessment of this business case.

- From a Procurement and Supplier Development (SD) perspective, since the tender was confined to one supplier, the Department would like review the SD commitments, the enforceability of these commitments and the current performance of this supplier against set targets on contracts that are currently in place. Transnet is therefore requested to provide all contracts with China South Rail (CSR) as well as a report on how CSR is performing against current SD commitments.

- Indication of whether other alternatives were considered is not evident in the business case. Whilst the 100 locomotives acquisition is one mitigation factor that is expected to partially mitigate the delays in 1064 locomotives delivery, what other alternatives were considered to mitigate the impact of the delay of the 1064 locomotive delivery.

- Moreover, the amount indicated in the certified excerpt from the minutes of the special Board of Directors meeting held on 24 January 2014 differs from the amount indicated in the Transnet's section 54 application. I therefore request a resolution of the board of directors approving the transaction at the current transaction amount of R4.84 billion as the one indicated in the section 54 application relates to the initial approved amount of R3.9 billion.

Lastly, it is of grave concern to me that Transnet has failed to notify me timeously of a transaction which is of such significance in your business, even if the projected quantitative value was initially estimated below the monetary threshold for approval.

The significance and materiality framework agreed to in the 2013/14 Shareholder Compact, clearly stipulates that Transnet should provide me with notification on all acquisition and disposal of assets above R2 billion. It would therefore have been my expectation that after the Board had approved this acquisition, prior to entering into negotiations with the supplier, Transnet would have provided a notification. This failure to provide a notification timeously, has denied the Department an opportunity to review and engage on pertinent issues regarding this acquisition earlier in the process. Going forward, Transnet should involve the Department far earlier in its project planning phase so as to allow for alignment between the Department and Transnet.

In spite of the concerns raised above, I do acknowledge the business need for the acquisition of these additional 100 locomotives for the coal line in order to avail more locomotives to be cascaded to the General Freight Business. I therefore, grant Transnet the approval to acquire the 100 locomotives subject to Transnet addressing the concerns raised above and providing the Department with the outstanding information as outlined above.

The Department therefore requests Transnet to fully submit the requested Information on or before 19 June 2014. As per normal, continual interaction is imperative so as to ensure that there is no misalignment/confusion on the expectation.

I trust that you will find the above in order.

Yours sincerely

MR. MALUSI GIGABA, MP
MINISTER OF PUBLIC ENTERPRISES
DATE: 2014/05/23

Mafika Mkwanazi, Chairman

TRANSNET

Our Ref No: MM/17556

Mr Malusi Gigaba, MP
Minister of Public Enterprises
Private Bag X15
Hatfield
0028

Fax: 012 431 1039

Dear Minister Gigaba

TRANSNET PFMA APPLICATION FOR THE ACQUISITION OF 1064 LOCOMOTIVES

Your letter dated 3 August 2013 regarding the above mentioned subject has reference.

Firstly, let me express my sincere gratitude for the timely granting of approval to acquire the 1064 locomotives. This acquisition is going to contribute significantly towards Transnet SOC Ltd ("Transnet") attaining its strategic objectives as set out in the Market Demand Strategy. This investment will not only take Transnet to new heights, but South Africa as well.

This letter seeks to respond to the queries raised and give you some level of comfort that Transnet is aligned to the broader objectives of the New Growth Path and other Government initiatives.

1. "A clear statement":

    a. "With regard to TE's vision in the locomotive supply chain."

Transnet Engineering ("TE")'s vision in the locomotive supply chain is to; provide an integrated function in respect of the design and construction of new locomotives for Transnet Freight Rail ("TFR") and also the African region. To this end TE has an aspiration to develop into a niche original equipment manufacturer ("OEM") for locomotives designed for African operating conditions and other narrow rail gauge territories.

    b. "The capabilities that need to be developed to realise this vision."

In the short-term TE would develop an enhanced capability through selectively seeking scope in the large 1064 locomotive contract. The areas that have been identified as strategic are contained in the attached list. **(Annexure A)**

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2. "TE's 7 year locomotive supply chain strategy indicating":

a. "Import component."

For an electric locomotive this would amount to approximately 23% of scope and for a diesel electric locomotive this would amount to approximately 31% of scope. The reason for the greater level of scope in diesel locomotives is to strategically position TE in this target market for Africa.

The 1064 procurement elevates the level of localisation from the roughly 24% at present to approximately 70% over two and a half years. The implication is that local industry will need to be providing considerably greater scope in this contract than was the case previously. We believe that TE can be positioned to considerably enhance local supplier development, accreditation and in the development of long-term supporting local manufacturing supply chains. This will require a partnership approach with the selected locomotive OEM's and also the development of appropriate support capacity at TE.

In the medium term TE would concentrate on developing capability and targeted intellectual property in the following areas as part of a broader strategy to develop into an OEM:

- Prime Contractor
- Systems Integrator
- Component Design
- Final Assembler
- Component Suppliers and lower tier supplier support

b. "TE internal production."

The responsibilities that are identified as critical to delivering these functions include the roles in the production process attached. **(Annexure B)**

c. "Outsourced portion to the private sector."

It is envisaged that local private sector companies would be dominant in the following areas of locomotive production:

- Alternator assembly and associated component manufacture,
- Manufacture of auxiliary power supply systems,
- Some portions of bogie and traction motor localisation, including locally produced components, but excluding bogie and traction motor assembly,
- Component production that can be sustainably undertaken in South Africa for parts of the braking system, cooling ventilation and filtration system, pneumatic supply system and wheel system,

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- Fabricated components and sub-assemblies in across various parts of a locomotive including driver cab fabrication, and
- For electric locomotives, the production of the main transformer and associated sub-systems.

d. "The broad conditions associated with outsourcing that will result in the building of a competitive national industry."

TE is committed to develop a comprehensive roadmap; a 3 to 5 year strategy and business plan to meet this objective and will have a strategic document by November 2013. Part of this strategy will be the required approach to enhancing localisation across South African industry to support the new emphasis on reaching and sustaining much greater local content percentages.

3. "Provide a clear plan to the strategic fit of the 1064 locomotive procurement to the broader road to rail migration objective".

The Transnet Market Demand Strategy is premised primarily on the growth of General Freight traffic from ~83mt in 2012/13 to ~180mt in 2019/20 (Corporate Plan 2013/14) such that General Freight tonnages comprise close to 50% of total TFR tonnages (vs 40% in 2012/13). The intent of this strategy is to begin the process of shifting rail friendly traffic from Road to Rail. The procurement of new locomotives is a key element of this strategy.

The strategy is starting to reflect signs of success as indicated by the slight increase in rail market share from 11.1% of tonnage and 29.3% of TonKm in 2010 to 11.5% and 29.9% respectively in 2012 (Source: 9th Annual State of Logistics Survey for South Africa 2012). Relative success is also reflected in the steady market share growth achieved by the Container and Automotive business unit:

	Total Ports	Long Haul
2011	13%	21%
2013	20%	31%

There are a number of drivers of the capital programme which is a decisive strategic intervention to eliminate legacy rail challenges. The primary objective is to modernise both General Freight rolling stock fleet and infrastructure network after decades of under-investment. This includes the strategy to modernise and standardise assets and includes the procurement of both diesel and new generation dual voltage electric locomotives to be deployed according to the network characteristics to achieve projected efficiencies and volume growth. The detailed strategy for the road to rail migration is contained in **Annexure C.**

4. "Transnet to provide the Department with a localization strategy for traction convertor, traction motors, diesel engine, bogies, electrical system, management system and control system."

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The attached slide presentation (Annexure D) provides a localisation strategy for the above and other components identified where opportunities exist. You would be pleased to note that Transnet is going well beyond the above list of components targeted for localization.

I hope that I have adequately addressed your concerns in this letter, however, consultation between the Department of Public Enterprises' staff and Transnet is on-going and our team will gladly assist further to address the issues raised in your letter. You are welcome to contact my office for further queries.

Kind regards

Mafika Mkwanazi
Chairperson
Date: 19/11/2013

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Annexure A

Development of capabilities in locomotive supply chain

Capabilities that need to be developed to realise the vision of locomotive supply chain in South Africa:

The following areas that have been identified as strategic:

- Co-design of fabricated bogies
- Manufacture fabricated bogie frame
- Manufacture locomotive carbody/cabs
- Design and equipping of drivers console/cab
- Assembly of HV/LV cable kits
- Design and manufacture of toilets
- Manufacture cubicles
- Bogie final assembling
- Assembly of engine in TE facilities
- Assembly of locomotives
- Under frame including fuel tank
- Painting of locomotive
- Assembly and testing of locomotive control and electrical systems
- Assembly and testing of wheel sets
- Assembly and testing of pantographs
- Brake valve assembly
- Final assembly traction motors and related components
- Traction motor load testing
- Defined work in respect of the Main Power Traction System
- Test and commission locomotives

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Annexure B

Roles in the production process

The responsibilities that are identified as critical to delivering these functions include the following roles in the production process:

Prime Contractor

- Contract management
- Stakeholder management
- Scope management
- Risk mitigation
- Customer benefits tracking

Systems Integrator

- Concept design
- Set component design parameters
- Component OEM's selection
- Simulate performance
- Assemble prototype
- Component test
- System test

Component Design

- Understand customer requirements
- Identify performance gaps
- Modify components to meet requirements
- Simulate design
- Build and test prototype

Final Assembler

- Secure supply chain
- Design assembly process
- User acceptance testing
- Continuous improvement

Component Supplier and Lower tier supplier support

- Secure supply chain
- Design assembly/ manufacturing process
- Quality testing
- Continuous improvement

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Annexure C

Road to Rail Migration Strategy

The Transnet Market Demand Strategy is premised primarily on the growth of General Freight traffic from ~83mt in 2012/13 to ~180mt in 2019/20 (Corporate Plan 2013/14) such that General Freight tonnages comprise close to 50% of total TFR tonnages (vs 40% in 2012/13). The intent of this strategy is to begin the process of shifting rail friendly traffic from Road to Rail. The procurement of new locomotives is a key element of this strategy. The strategy is starting to reflect signs of success as indicated by the slight increase in rail market share from 11.1% of tonnage and 29.3% of TonKm in 2010 to 11.5% and 29.9% respectively in 2012 (Source: 9th Annual State of Logistics Survey for South Africa 2012). Relative success is also reflected in the steady market share growth achieved by the Container and Automotive business unit:

	Total Ports	Long Haul
2011	13%	21%
2013	20%	31%

There are a number of drivers of the capital programme which is a decisive strategic intervention to eliminate legacy rail challenges. The primary objective is to modernise both General Freight rolling stock fleet and infrastructure network after decades of under-investment. This includes the strategy to modernise and standardise assets and includes the procurement of both diesel and new generation dual voltage electric locomotives to be deployed according to the network characteristics to achieve projected efficiencies and volume growth. General Freight commodities projected to reflect high growth over the seven years of the Market Demand Strategy are:

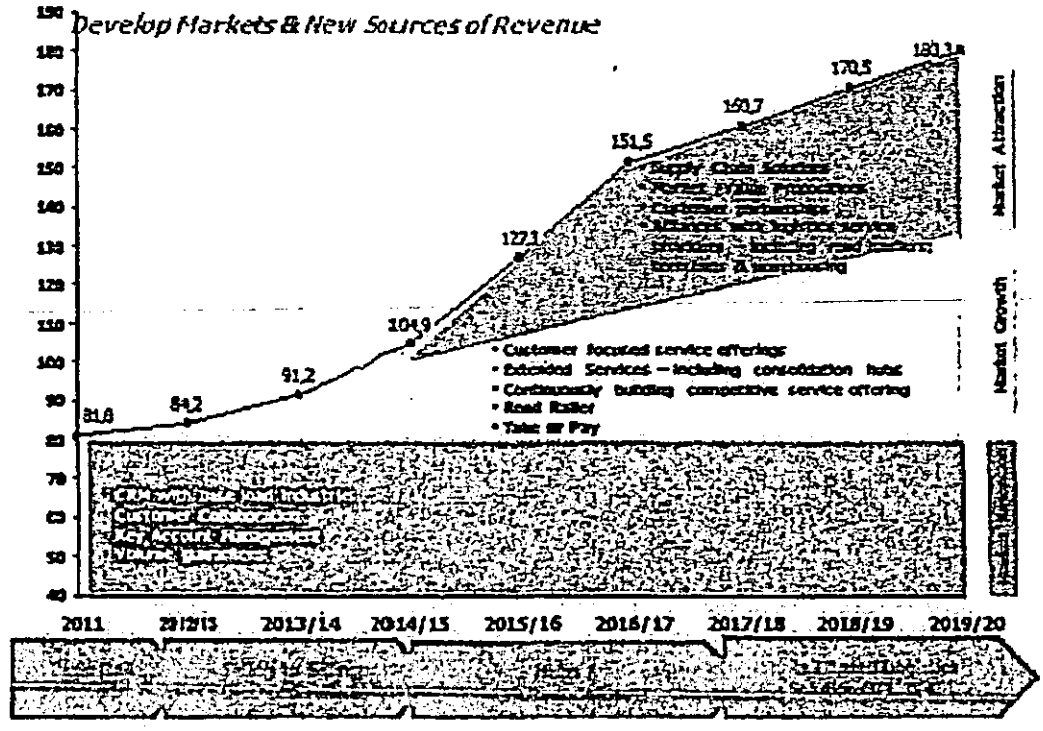
Growth Commodities

Commodity	Sector / Segment	CAGR
Iron and Steel	Bulk Mining & Manufacturing	20.8%
Export Coal (Non RBCT)	Bulk Mining Export	18.9%
Eskom Coal	Bulk Manufacturing	17.6%
Manganese Export PE	Bulk Mining Export	15.8%
Iron Ore	Manufacturing	15.1%
Chrome & Ferrochrome	Bulk Mining & Manufacturing	12.1%

Commodity	Sector / Segment	CAGR
FMCG	Beneficiated / Palletised / Containerised	10.7%
Agriculture	Bulk export / processing	9.94%
Mineral Mining	Bulk Mining & Manufacturing	9.8%
Automotive	Import / Export	9.2%
Coal (Domestic other)	Bulk Manufacturing	6.6%
Industrial Chemicals	Bulk Manufacturing	5.9%
Wood & Wood product	Bulk Export / processing	5.7%
Fertilizer	Bulk Export / processing	4.6%
Intermodal wholesale	Beneficiated / Palletised / Containerised	4.6%
Cement	Bulk Manufacturing	4.3%
Bulk Liquids	Bulk Manufacturing	3.7%

The graphic below is illustrative of the Road to Rail strategic journey in the growth of General Freight tonnage and market share.

Road to Rail Strategy for General Freight Volume & Market Share Growth



Market Retention: Retaining and sustaining current business

As a first priority, locomotives will be deployed to retain existing base load Siding to Siding General Freight traffic and to cater to the organic growth of existing customers. This retention requires significantly improved efficiencies to be achieved through reliability of service with improved throughput time. TFR currently projects efficiency improvements of 29% to 37% due to the deployment of new locomotives. This is evidenced by the improvements already achieved on corridors where new locomotives have already been deployed:

- 60% efficiency improvement of the Class 43 Diesel locomotives from 5 000 000 to 8 000 000 GTK/Loco/month on the Phalaborwa-Richards Bay corridor
- The 19E locomotives deployed on the Export Coal corridor have achieved efficiency improvements of 18% (2011/12 – 2013/14 YTD). Similarly improvements of 28% have been achieved with the 15E locomotives on the Export Iron Ore line

The retention of existing traffic is the current focus and will remain core to the strategy over the time horizon of the MDS. Dual voltage electric locomotives will initially be deployed to critical flows such as:

- Postmasburg to Port Elizabeth (Manganese)
- Port Elizabeth to Kazerne (Containers and Cars) and
- Rustenburg to Richards Bay (Chrome and Ferrochrome).

This deployment of new locomotives will eliminate the need for lengthy stopovers on corridors to change locomotives and carry out brake and other safety related tests thus improving the reliability of services. The imperative to improve the execution and efficiency of these services is critical to building the goodwill of existing customers in order to gain increased percentages of their freight and to build the TFR service reputation in the marketplace. This is vital for the success of future Road to Rail shift strategies.

Market Growth

The next imperative in the Road to Rail shift strategy is to capture bulk mining and manufacturing rail friendly commodities that are currently being conveyed by road hauliers. This is the core competency of rail and must be exploited. Locomotives will thus be deployed to corridors and flows to achieve organic growth in such commodities as Eskom coal flows, magnetite, chrome and ferrochrome as well as earning the right to transport finished goods produced by existing customers, for example in the Steel and Cement industries. Due to retirement of older locomotives, additional locomotives will be required to facilitate this growth.

Market growth of agricultural products such as Grain, Maize and Wheat as well as Timber products will also contribute to Road to Rail shift. Older locomotive types will be cascaded as appropriate to consolidate traffic from Branch lines or other feeder areas to strategic consolidation- hubs where longer trains (eg. 100 – 120 timber wagon trains) are built to transport product to ports for export or to mills for further processing

Market Attraction: Collaboration and joint logistic solutions

Market attraction of new customers and / or new markets involves the development of inter-modalism or rail-based logistics services. Typical commodities to be targeted are manufactured or beneficiated freight and FMCG cargo that can be containerised or palletised. This includes:

- Import, export and cargo destined for domestic or regional consumption moving between terminals or distribution centres;
- Finished goods e.g. Bagged cement, steel products, automotive and machinery parts, textiles, foodstuff increasingly require some form of intermodal solution.

It is likely that such growth will be achieved in the later years of the strategic plan. Plans are however, currently underway in preparation for attracting such markets. These market development initiatives include:

- Collaboration with Port Terminals for mass evacuation of containers by rail from the Port of Durban to inland destinations
- Development and implementation of car racks in April 2013 enabled the transport of cars to and from Isipingo and Point in Durban. This has facilitated the effective improvement of cars transported to Kaalfontein.

- Development of road-railer wagons as a prerequisite for seamless intermodal services. The prototype will be ready for testing in 2015 and will ramp up from this point on once tests are completed.
- Development of the Domestic Intermodal strategy initially focusing on a road to rail shift on Natcor and CapeCor. A number of long haul trains per day will be operated between consolidation hubs and "last mile delivery" will be done by road hauliers. (Cost will be determined by road distances and an integrated price will be a critical success factor). 18E Locomotive will be cascaded into the Natcor from other areas. There will be increased utilisation of the locomotive types currently used on the CapeCor
- These services can be optimised by partnerships with road hauliers, freight forwarders, and terminal operators. In this regard, TFR has signed an MOU with Imperial Logistics and with BarlowWorld to enable the joint development of such solutions

Locomotive Deployment

As indicated in the Business Case, new locomotives are required to replace aged fleets that are unreliable and costly in order to contribute to stability which will encourage growth. Approximately 700 locomotives will be deployed to replace old locomotives that will be retired and thus to sustain General Freight tonnages of between 80 and 85 million tons per annum (mtpa). These new locomotives with improved reliability and availability will contribute significantly to operator ease and to transform TFR to a predictable and scheduled Railway. The remaining 364 locomotives will be deployed to enable growth of between 90 and 95mtpa. Further growth to levels exceeding 100mtpa will be enabled by:

- The deployment of the 95 x Class 20E locomotives currently being manufactured for deployment to the Manganese export corridor
- Cascading of 10E and 7E3/4 locomotives from the Coal Export line to General Freight flows with the introduction of a further 100 heavy haul locomotives into the Coal Line.
- The optimised deployment of locomotives to corridors appropriate for operating models applied for freight typologies being serviced. This will contribute to improved locomotive utilisation and efficiencies

Beyond locomotives

The Road to Rail strategy is however not exclusively dependent on locomotives but requires strategic alignment of all elements of the Operating Model – Wagon upgrades and new builds; Network upgrades, Train Authorisation systems, Improved Service Designs and Initiatives for operational planning, monitoring and deviation management and execution .

Annexure D

TRANSNET

The 1064 locomotive localisation opportunity for South Africa including TE role

September 2013

The purpose of this slide pack is to addresses the following:

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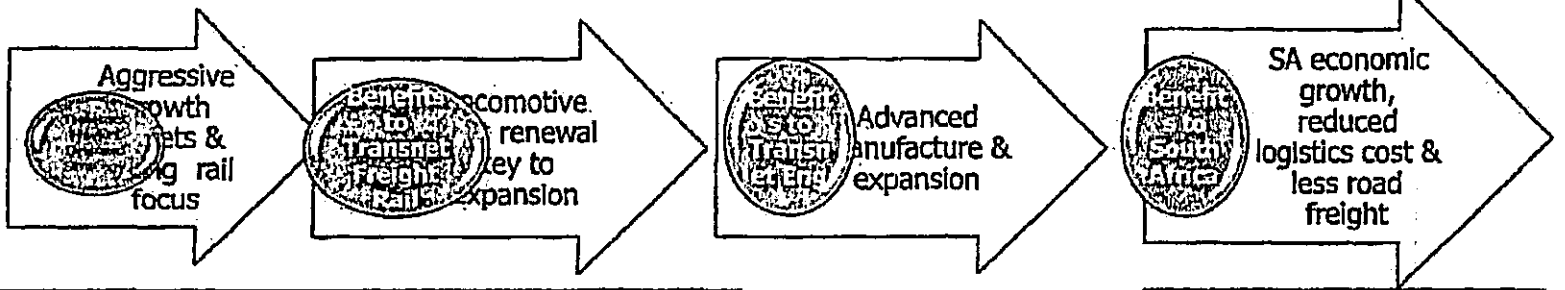
- To identify the benefits of increasing localisation through the order for 1064 locomotives.
- Provide clarity in respect of the process followed to date to identify opportunities for localisation and an elevated role for TE in production and the development of skills and capability.
- To provide clarity of TE's expected future role and a vision for elevating TE's capability to become a locomotive OEM.
- To provide clarity of TE's role in assisting to localise components used in a locomotive through the development of a localisation strategy.

Locomotive renewal benefits Transnet Freight Rail, Transnet Engineering and the South African economy

TRANSNET



- Transnet as enabler of economic growth,
- Productivity and operational efficiency improvements particularly in rail,
- Financial stability.

599 dual-voltage electrics and 465 diesels critical to achieving:

- Reliability,
- Operational efficiencies,
- Reduced cycle times & turnaround,
- Reduced operating cost,
- Rapid growth in coal, manganese, container & auto market

- Design and integration capability in respect of locomotives.
- Enhanced research base in conjunction with OEMs to develop and refine technologies for the South African and African market

- Substantial growth in exports of manufactured products, manganese, iron ore, coal, etc,
- Multiplier benefits from Transnet, mining and manufacturing expansion,
- Externality benefits from shift from road to rail.
- Lowering cost of doing business

Benefits associated with taking whole life costing view, including initial manufacture and ongoing maintenance.

Linking Key Performance Indicators between Transnet Freight Rail and Transnet Engineering

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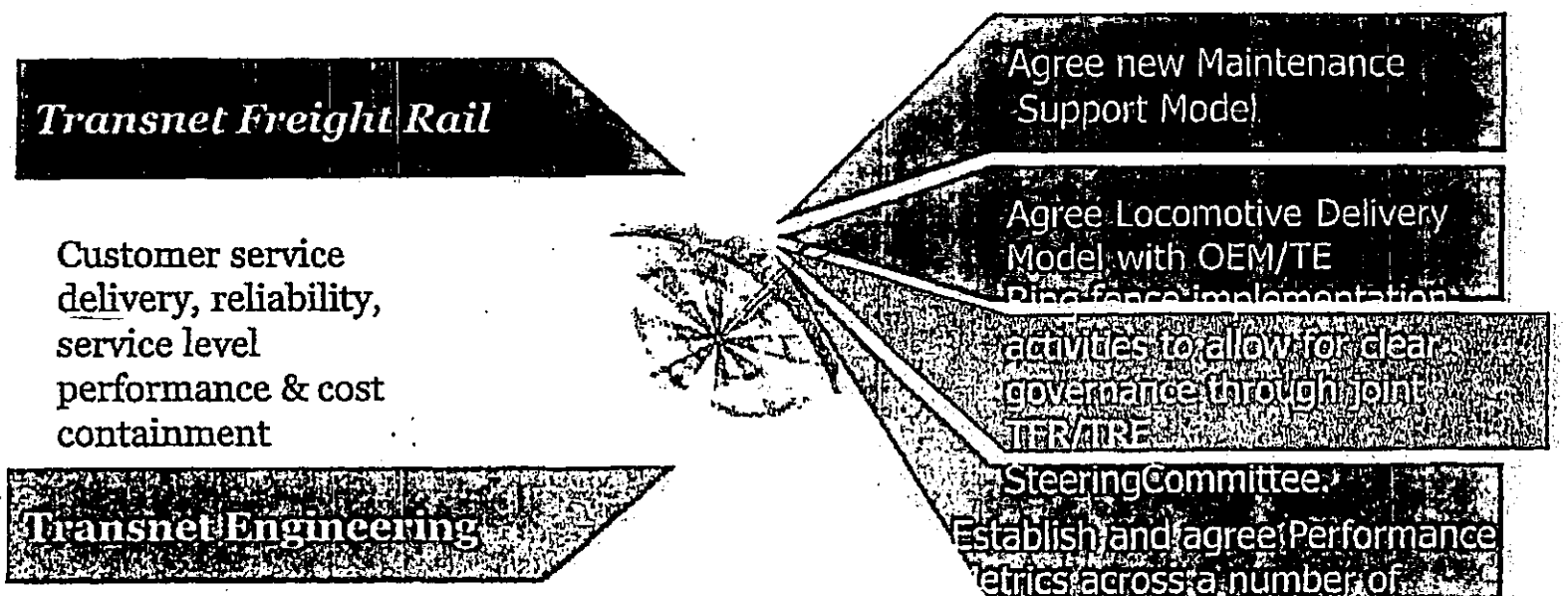
Linking the performance of Transnet's MDS to the KPI's of both TFR and TE is critical to achieving the success of the rail expansion strategy



Unique opportunity for local manufacture & re-positioning rolling stock industry

TRANSNET

1 Leverage

Government

Rolling stock procurement almost completely within state owned companies, predominantly in Transnet and PRASA.

Private Sector

Sectors such as mining and the power sector bear close similarities in the production processes and heavy engineering requirements associated with rolling stock.

Industrial Policy Action Plan (DTI)

DTI have identified the localisation opportunities in rolling stock as part of a number of key sectors

Minimum threshold requirements for locomotive localisation:

- 55% for diesel locomotives, and
- 60% for electric locomotives.

8 1064 order size is unique

Economies of scale in purchasing 1064 locomotives sufficiently large to create real localisation opportunities.

Little localisation price premium to Transnet.

Time to localise

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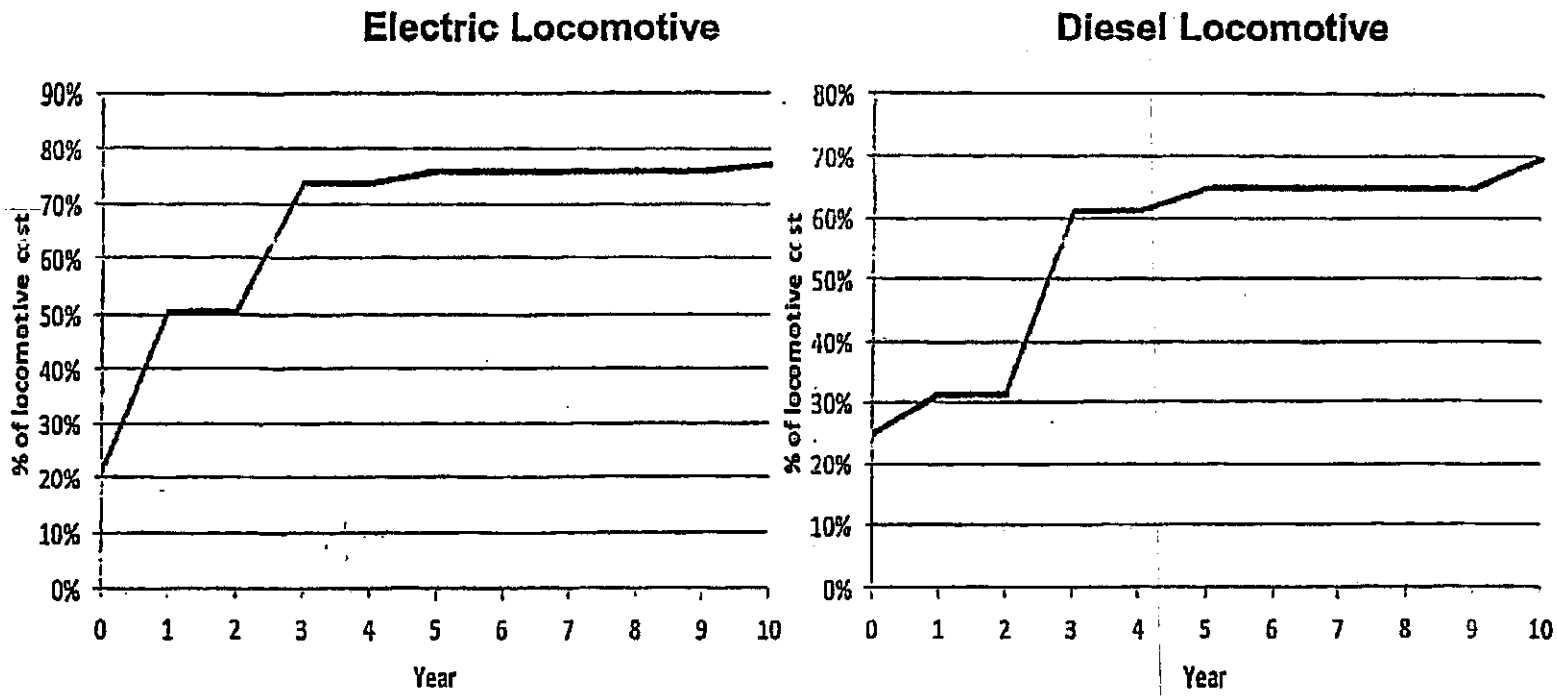
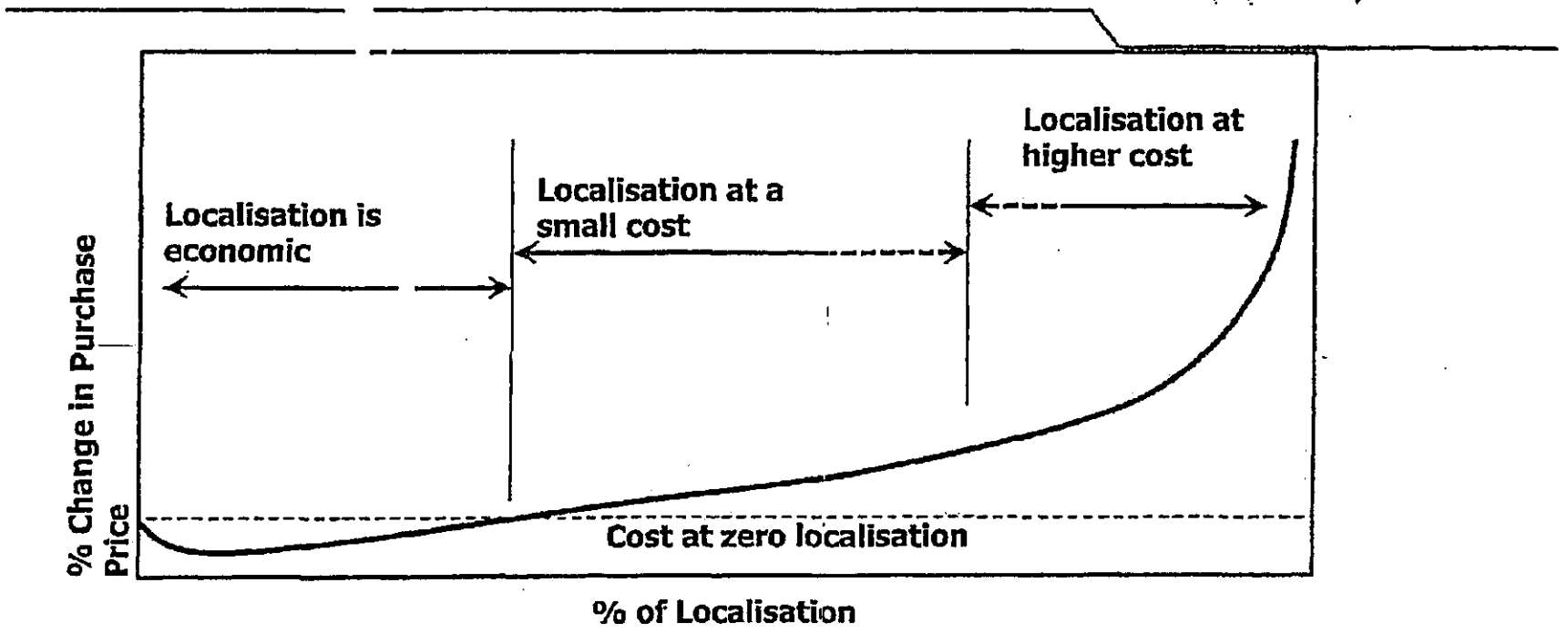
SA component suppliers are not yet able to produce full range of components. It will take 3 years to gear industry up



Cost to Localise increases with increasing level of localisation

TRANSNET



Enforcing higher levels of local content will incur high cost of localisation which cannot b justified through net benefits to RSA

A grey zone exists where the limit of localisation is dependent on OEM investment in manufacturing in South Africa. Part of the way the Transnet RFP is structured is to attempt to capture as much localisation as possible within the grey zone without overly

Each component within a locomotive has its own price verse localisation curve

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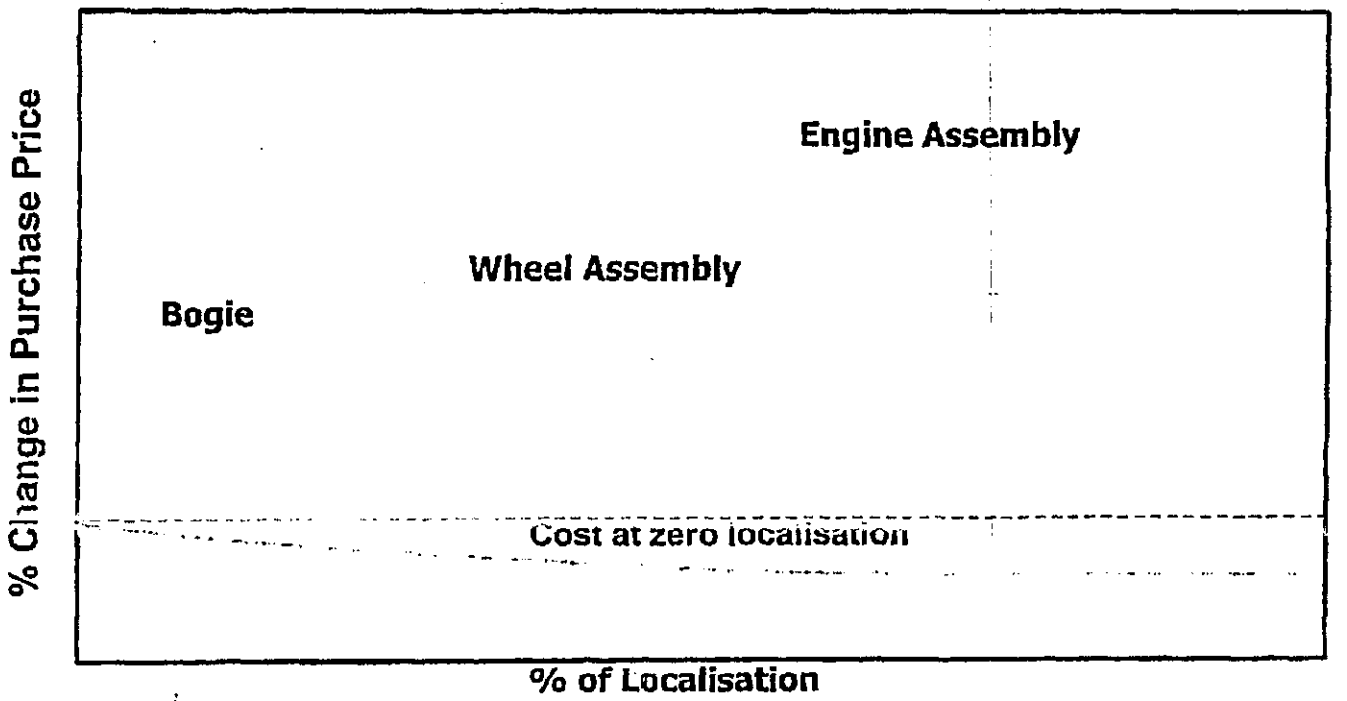
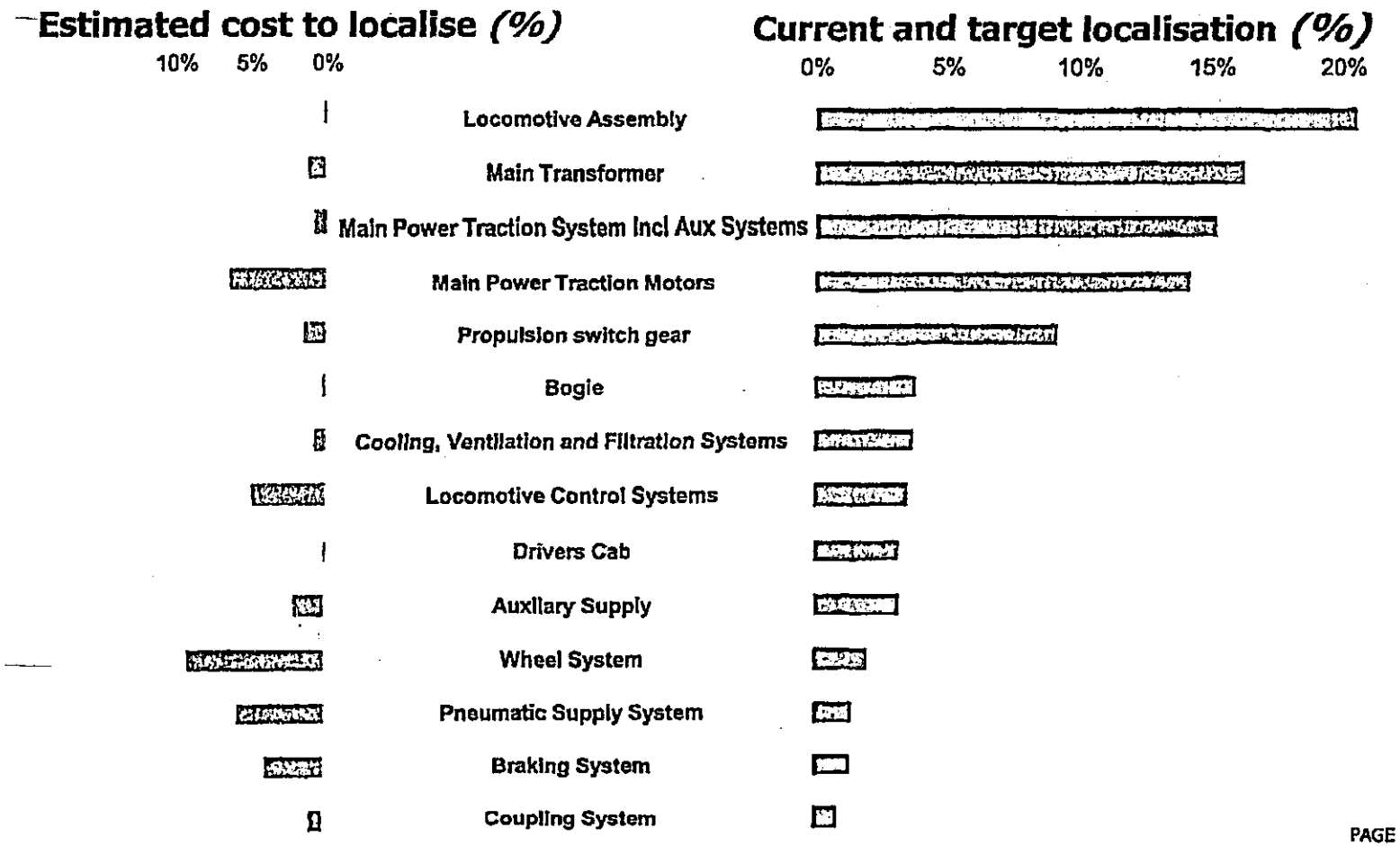


- One of the characteristic of the price to localisation curve for many component items is that the price-cost of localisation grows rapidly at high levels of local content requirements (80% to 100%).
- Forcing high localisation requirements on complex components will result in uneconomic price cost of localisation as well as possible compromises in safety critical items

Diesel locomotive

TRANSNET

Electric locomotive



Diesel locomotive

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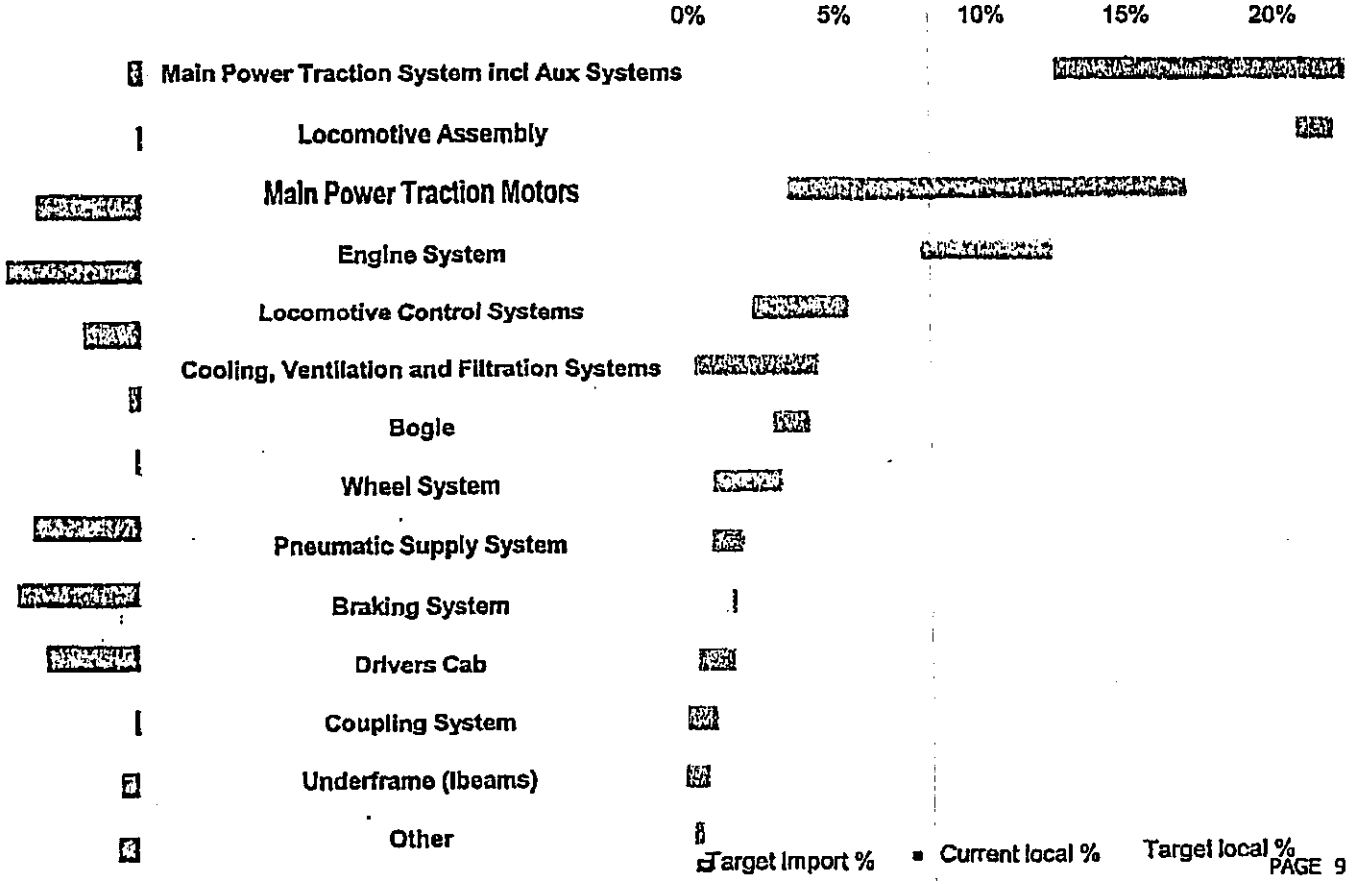
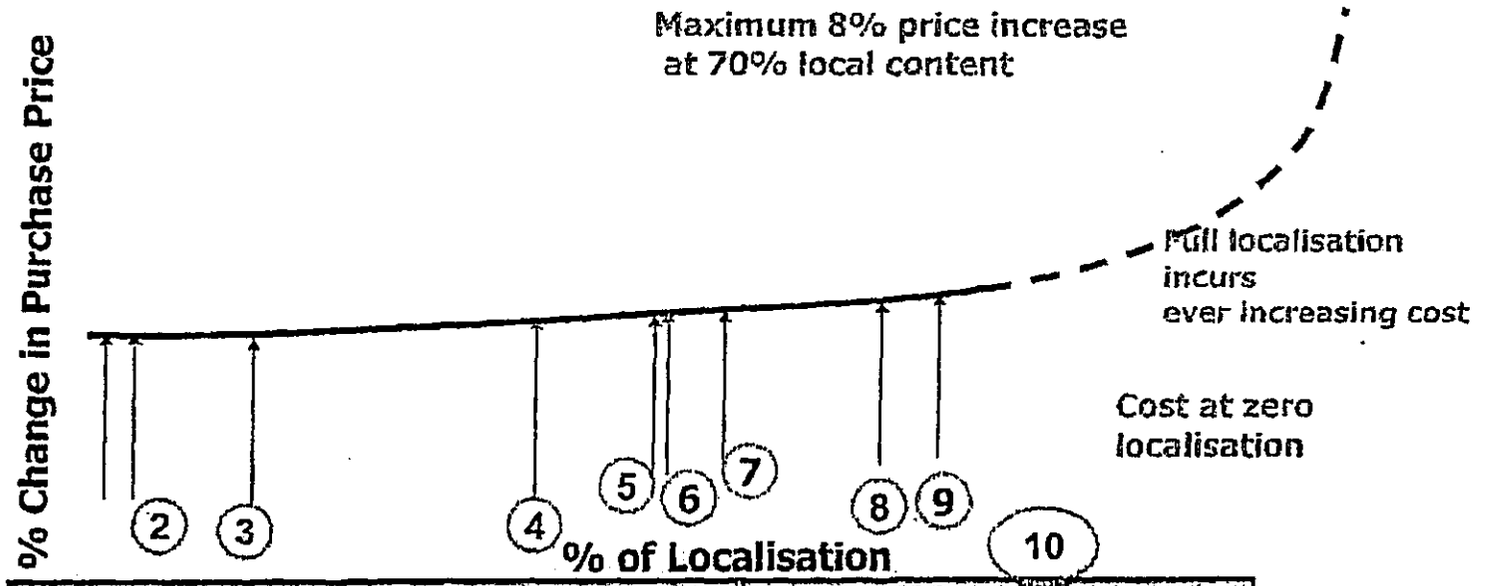
Estimated cost to localise (%)

Current and target localisation (%)



Local content of 70% incurs a less than 2% average price cost of localisation

TRANSNET



Item #	Category	% increase	Item #	Category	% increase
1	Drivers cab	0.27	6	Aux supply	2.1
2	Bogie	0.27	7	Control system	3.4
3	Loco assembly	0.33	8	Traction motors	6.3
4	Main transformer	1.3	9	Wheel system	6.5
5	Prop switch gear	1.5	10	Engine system	8.0

Price competitive localisation at a low price cost of localisation is dependent on managed process that can provide scale

TRANSNET

Three conditions need to be met:

1. Components are localised up to a level that is economically viable (i.e. that price cost of localisation for each set of components are economic),

2. Realistic time frame targets are set to reach full localisation potential. Shortening these time periods results in uneconomic price-cost of localisation, and

3. Minimum annual order size for locomotive production is guaranteed to the market over the life of the 1064 locomotive supply contracts.

The benefits of locomotive localisation at 70% far outweigh the localisation price cost of localisation paid

TRANSNET

Manufacturing Benefits

- Key industrial capability established in:
  - Traction Motors and traction control systems,
  - Locomotive control systems,
  - Electrical systems,
  - Large Engines,
- Benefits to related sectors such as, electromechanical, electrical machinery, software and electronics, motor and other light manufacturing will be significant.

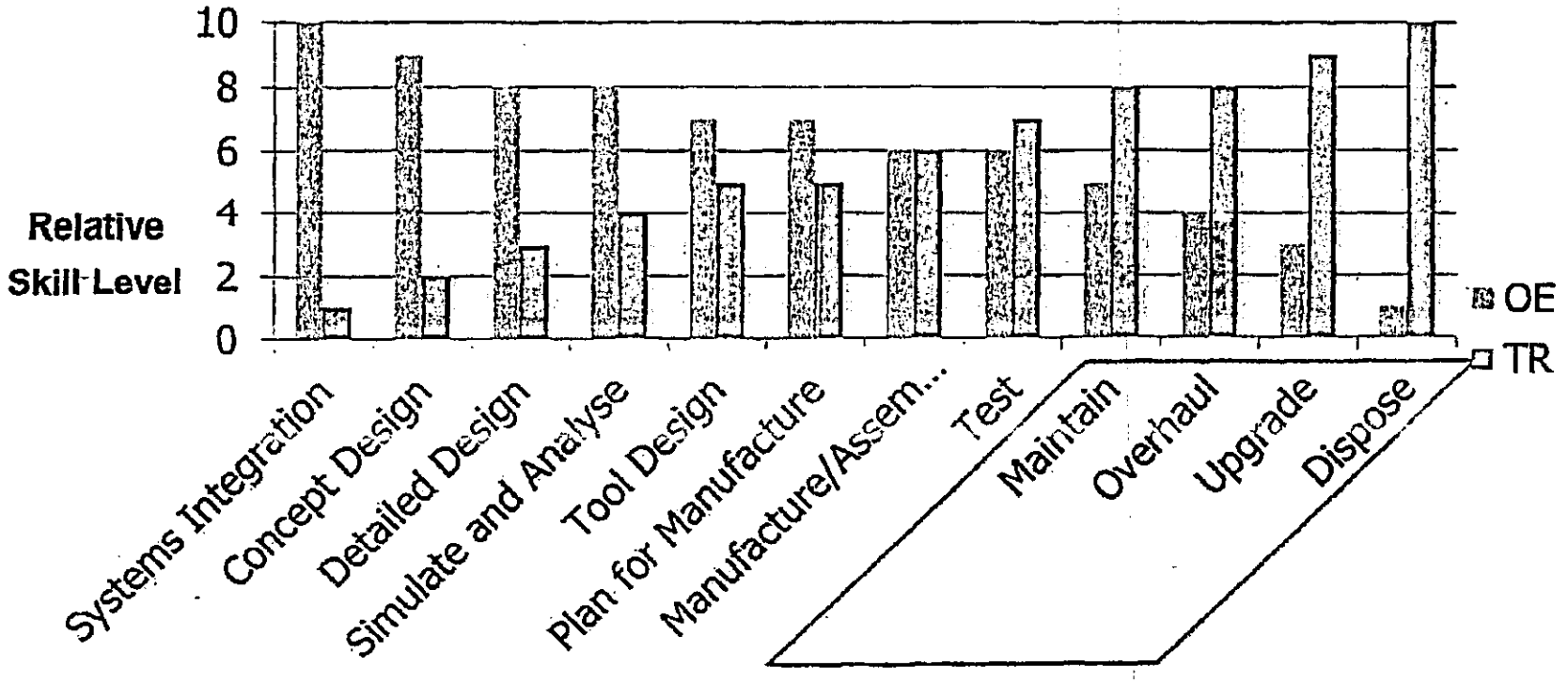
National Benefits (South Africa)

- Enhanced national capability across a range of sectors.
- Multiplier benefits of localising R1 of a locomotive is expected to have multiplier down stream benefits of 2.74* times as much.
- This comes at a average price premium of less than 2% in the 60% to 75% localisation range.

- Using multiplier data published as part of IPAP (2011) we estimate a benefit to the South African economy of localisation of part of the supply chain to be R68bn for an expected total increased spend on the 1064 locomotives of R400m
- The resulting Benefit to Cost ratio is 170 to 1 in favour of localisation

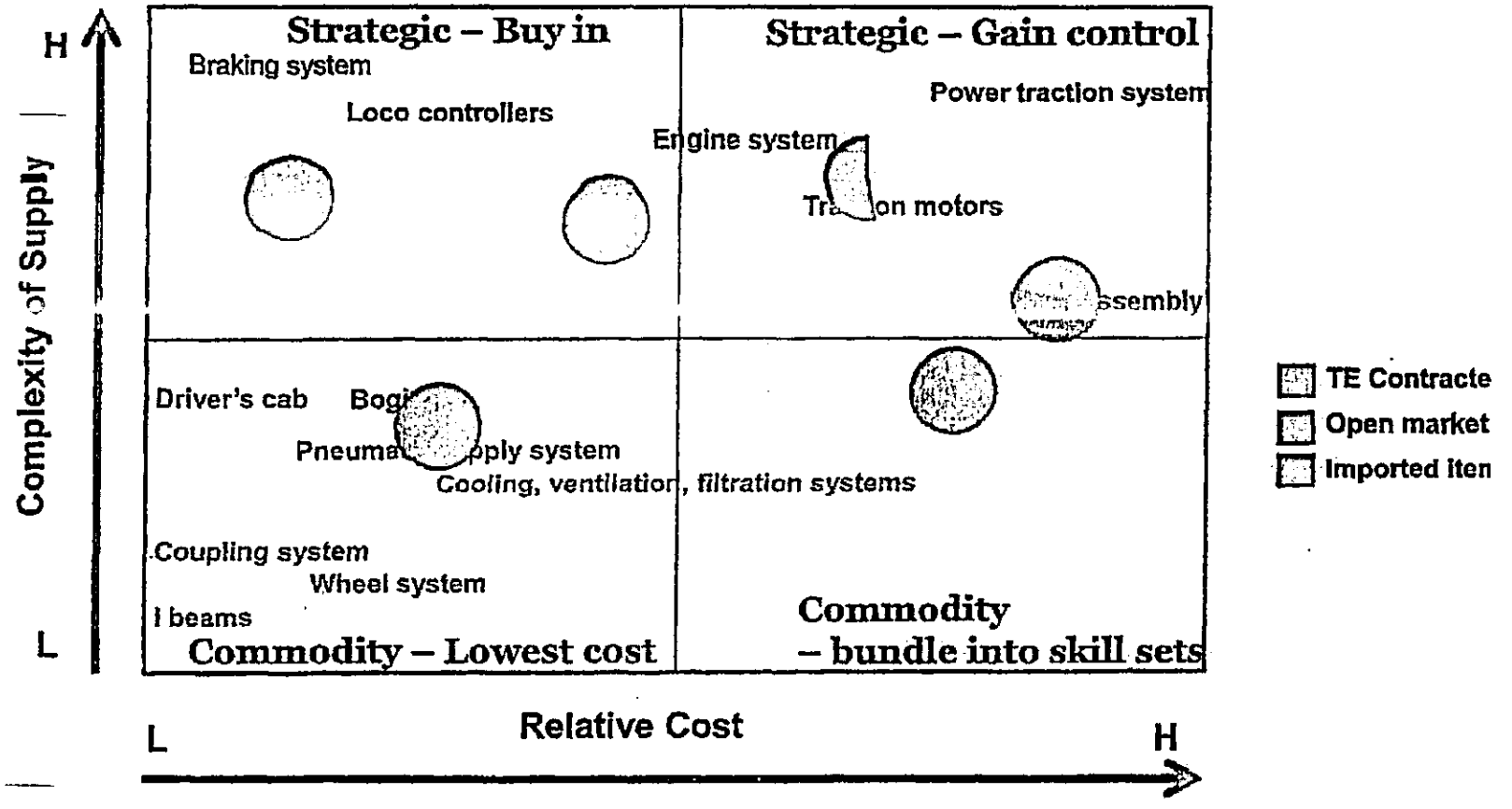
Skills and competencies in TRE need to be developed and aligned with the skills and competencies required of a locomotive OEM

TRANSNET



Utilising a sourcing strategy matrix indicates opportunities for TE to work with local industry to re-position itself

TRANSNET



841

IP transfer from OEM to TE defined based on elevating TE's strategic capability

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supply chain capability

Manufacture	Design assembly process
	Develop manufacturing BOM
	Build jigs and assembly line
	Build/assemble product
	Manage cost and quality
	User acceptance testing
	Continuous improvement
Manage Supply Chain	Understand demand
	Identify optimal supply sources
	Assign inventory levels and locations
	Expidite supply chain
	Manage supplier accreditation and improvement programmes
	Continuous improvement

New Product Development	Understand emerging technologies
	Manage design and systems integration
	Manage Component Design
Gain New Business	Identify market opportunities
	Forecast future demand
	Develop marketing plan
	Prepare competitive bids and proposals
	Managing contracts and client relationships

Gap analysis for after sales service & strategic support requirements

After Sales Service	Training maintainers and operators
	Managing warrantees
	Manage spares and parts
	Manage product support services
Supporting Business	Setting business direction
	Manageing staff
	Managing capital
	Managing risk
	Managing assets

842

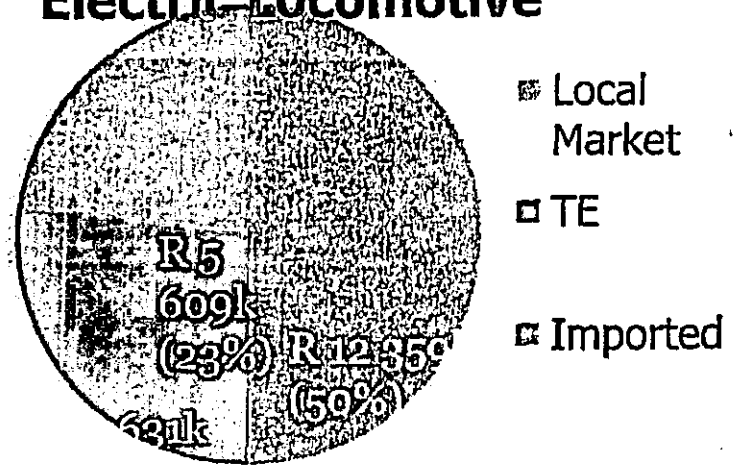
The proposed division of locomotive spend repositions Transnet Engineering & creates significant scope for private sector involvement

TRANSNET

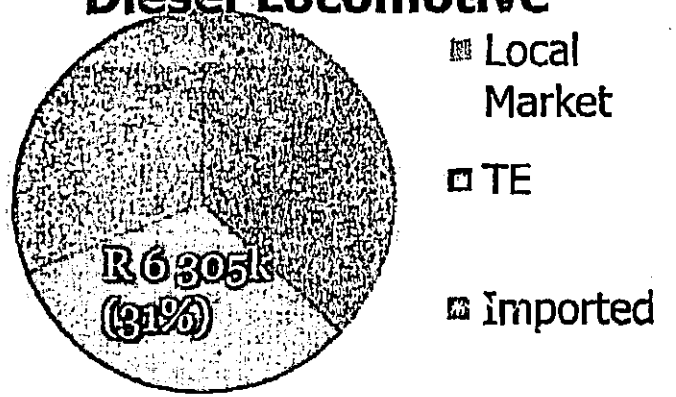
The scope of work estimates are based on:

- Strategically positioning Transnet Engineering in; locomotive assembly, bogies, engine assembly, locomotive control systems, traction motors and main power traction systems, and
- Creating significant scope for competitive private sector participation in areas where SA has competitive advantage and which display localisation potential.

Electric Locomotive

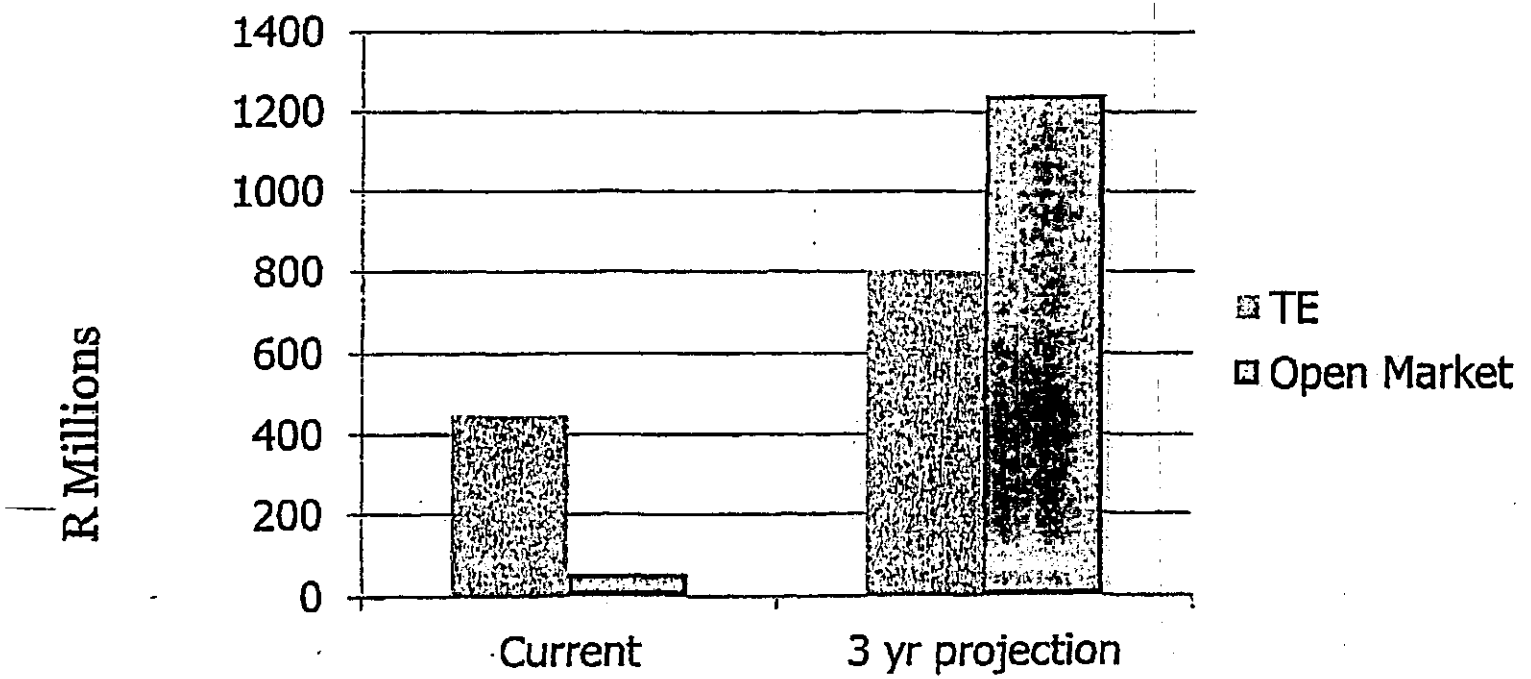


Diesel Locomotive



TE's workload is projected in increase by an estimated 77% over the next 3 years, whilst creating significant opportunities for the private sector

TRANSNET



*Based on projected manufacture of 50 diesel locomotives and 70 electric locomotives by year 3

844

Next steps in the 1064 Procurement Process

TRANSNET

The process will be adjusted as follows to strategically position TE and provide increased localisation scope:

- **TE Ideal Scope:** A process is currently underway to identify a TE '1064 migration plan' in strategically identified sub-assemblies and components of a locomotive in order to elevate TE to OEM status. The plan will take account of proposed TE scope over time, IP transfer, proposed local content percentages and a supply chain strategy incrementally applied over time.
- **1064 Negotiation Process:** Local content, TE scope and IP transfer to TE and local industry are key elements to be negotiated with shortlisted bidders. TFR will conduct the negotiation based on the above TE '1064 migration plan'. This will provide a planned migration, with minimum required scope and IP requirements, and items that may be regarded as negotiables identified for each sub-assembly or component.
- **Localisation strategy:** The above '1064 migration plan' will identify the localisation strategy to be applied in each sub-assembly or component. Procurement may be managed by the OEM, TE or migrated from the OEM to TE over time.

Expected timeframes to implement the 1064 transaction

TRANSNET

- **TE Ideal Scope:** This scope will be developed and aligned to a 'generic locomotive' for input to the negotiation process and will be complete by October 2013. The document will seek to provide clarity on the manufactured components and other processes which TE would be identified to undertake. It will also provide options for TFR that may be used as part of the negotiating strategy.
- **Localisation strategy:** The '1064 migration plan' will identify the localisation strategy to be applied in each sub-assembly or component and will be complete by October 2013. The role of TE in the localisation strategy will be defined and is likely to be different across the different sub-assemblies/components sets making up a locomotive. A high-level TE Industry Supply Chain strategy will be defined
- **TE Locomotive OEM roadmap:** Will be developed at a strategic level by November 2013 and as a detailed roadmap by March 2013, and
- **1064 Negotiation Process:** The negotiation process will be led by TFR and initiated by March 2013 and is expected to be concluded by July 2014.

Expected timeframes to implement the 1064 transaction

TRANSNET

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- ***1064 Negotiation Process:*** The negotiation process will be led by TFR and initiated by March 2013 and is expected to be concluded by July 2014.

Conclusion – Localisation focus for 1064 locomotive order

TRANSNET

Sustained opportunities for local manufacture.

- Transnet will create a 10 year delivery stream of contracts for new locomotives.
- Ongoing maintenance support will be required for a growing Freight Rail fleet.
- Transnet to work closely with private sector to secure quality production capability.

Elevated local manufacturing capability a huge benefit to SA

- Multiplier benefits to SA are considerable.
- Employment, job creation, skills development & IP transfer in related manufacturing industries.
- Support companies with strong and improving BBBEE credentials .

Provide reliable assets to Transnet Freight Rail to deliver MDS

- Quality assets linked to improved maintenance regime.

Elevate Transnet Engineering's strategic capability in locomotives

- Elevate Transnet Engineering's strategic capability in locomotives.
- This will create further opportunities for localisation and link to maintenance cycles.

Negotiations with short-listed bidders will define a role for Transnet Engineering

- Prescribed scope & knowledge transfer requirements from the OEM to Transnet Engineering will be negotiated with bidders.

Relationship with Shareholder

- Clarity on localisation requirements is to form part of a Shareholder Compact.

M/3/3/1117

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Ref. M4/1/20 (1293/13)

Mr Mafika Mkwanazi
Chairperson of the Board
Transnet SOC Ltd
P O Box 72501
PARKVIEW
2122

Dear Mr Mkwanazi,

TRANSNET'S APPLICATION IN TERMS OF SECTION 54(2)(d) OF THE PUBLIC FINANCE MANAGEMENT ACT FOR THE ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET FREIGHT RAIL'S GENERAL FREIGHT BUSINESS

I have noted Transnet's intention to acquire 1064 locomotives over the next seven (7) years at an estimated cost of R38.6 billion. I am aware that the acquisition aims to facilitate the ramp up in volumes transported from the current 80 million tons to 170 million tons as envisaged in the Market Demand Strategy (MDS) which forms the basis of Transnet's 2013/14 Corporate Plan.

However, I am concerned that the profitability of the project is highly dependent on Transnet's General Freight Business (GFB) being able to grow the volumes transported at amounts above GDP growth and tariffs charged at above CPI. Failure to achieve these optimistic growth figures would have an adverse effect on the expected revenues and thus the profitability of the project. Moreover, potential fluctuations in the operational costs could also adversely affect the profitability of the project.

The success of the project entails further capital expenditure, including the purchase of wagons and other expansionary expenditure is incurred. Therefore, I will be expecting a further Section 54(2) disclosure on all the relevant capital expenditure associated with the project. Furthermore, Transnet must submit a detailed implementation plan demonstrating how the above GDP growth volume increases and the above inflation tariff increases anticipated in the MDS will be achieved together with the possible mitigation strategies. In addition, operational costs must be monitored and rigorously controlled throughout the lifespan of the project to avoid any cost escalations.

Moreover, I have noted that, whereas Transnet is claiming that increasing locomotive capacity and efficiency will lead to lower tariffs for customers; real increases in tariffs

are in fact being projected to sustain the project. Transnet must provide regular feedback to National Treasury on their initiatives to attract customers from road to rail.

I look forward to the finalisation of the project and request that Transnet submit quarterly feedback to National Treasury on the status of the acquisition and the above mentioned related issues.

I trust that you will find the above to be in order.

Yours sincerely

PRAVIN J GORDHAN
MINISTER OF FINANCE
Date: 20 - 10 - 2015

cc Mr MKN Gigaba, MP
Minister of Public Enterprises

Appendix 44 851

Mafika Mkwanazi, Chairman

TRANSNET

Our Ref No: MM/17556

Mr Pravin Gordhan, MP
Minister of Finance
Private Bag X115
PRETORIA
0001

Fax: 012 323 0911

Dear Minister Gordhan

TRANSNET'S PFMA APPLICATION FOR THE ACQUISITION OF 1064 LOCOMOTIVES TFR'S GENERAL FREIGHT BUSINESS

Your letter dated 31 October 2013 regarding the above mentioned subject has reference.

Thank you for your response to Transnet's application. The contents have been duly noted and your interest in the health and sustainability of the Transnet b· siness is welcomed. This acquisition is going to contribute significantly towards Transne attaining its strategic objectives as set out in the Market Demand Strategy. This investm· · will not only improve Transnet's market share, but will also contribute to the attainment c he New Growth Path and National Development Plan.

This letter seeks to address the concerns raised and provide you with cc ort that Transnet is managing the transaction and the business in an acceptable manner.

1. **"Transnet's General Freight Business ("GFB") ability to gro· the volumes transported at amounts above GDP growth and tariffs charged at ·bove CPI".**

   Demand exceeds capacity in a number of commodities. The Transnet M et Demand Strategy is premised primarily on the growth of General Freight traffic fro. ~83mt in 2012/13 to ~180mt in 2019/20 (Corporate Plan 2013/14) such that Gene l Freight tonnages comprise close to 50% of total TFR tonnages (vs 40% in 2012/13). ıe intent of this strategy is to begin the process of shifting rail friendly traffic from roa to rail. The procurement of new locomotives is a key element of this strategy as loc motive capacity is the key constraint towards acceleration of the shift of commodities from road to rail.

The strategy is starting to reflect signs of success as indicated by the slight increase in rail market share from 11.1% of tonnage and 29.3% of TonKm in 2010 to 11.5% and 29.9% respectively in 2012 (Source: 9th Annual State of Logistics Survey for South Africa 2012).

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*Executive

Group Company Secretary: ANC Ceba

www.transnet.net

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Relative success is also reflected in the steady market share growth achieved by the Container and Automotive business unit:

	Total Ports	Long Haul
2011	13%	21%
2013	20%	31%

In addition, the Containers and Automotive Business ("CAB") unit grew volumes by 28% in the past financial year, well in excess of GDP growth. In 2011, the business also grew in excess of 22% p.a.

There are a number of drivers of the capital programme which is a decisive strategic intervention to eliminate legacy rail challenges. The primary objective is to modernise both General Freight rolling stock fleet and infrastructure network after decades of under-investment. This involves the strategy to modernise and standardise assets and includes the procurement of both diesel and new generation dual voltage electric locomotives to be deployed on the network according to the network characteristics to achieve projected efficiencies and volume growth. The detailed strategy for the road to rail migration is contained in **Annexure A.**

Furthermore, mitigation strategies have been developed to sustain volume growth. These strategies demonstrate how Transnet Freight Rail plans to achieve volume growth at amounts above GDP growth. **Annexure B** contains growth strategies for Domestic Coal, Automotive, and Containers on rail.

TFR conducts road versus rail cost studies at regular intervals to assess, among others, the tariff differences between modes. These studies are commodity specific and inform the extent to which rail tariffs can be increased without impacting TFR and customers' competitiveness. TFR places emphasis on balancing cost recovery with customers' willingness to pay as well as optimising revenue through targeting the appropriate mix of traffic to grow revenue per ton in order to ensure that TFR meets both its financial targets and serves its public mandate.

2. **"Increasing locomotive capacity and efficiency will lead to lower tariffs for customers; real increases in tariffs are in fact being projected to sustain the project".**

Increased locomotive capacity and operational efficiencies will improve customer satisfaction and accelerate a modal shift from road to rail. This migration of rail suitable traffic from road to rail will lead to lower tariffs to those customers when compared to the cost of using road alternatives. For the overall General Freight Business a significant increase in weighted average revenue per ton is required to achieve full economic cost recovery. TFR however does not support "step change" tariff increases as this could potentially disrupt and impact industry and customer competitiveness. Rail tariff increases are commodity and service specific and vary based on the pricing structure which includes factors such as (operating cost, customers' willingness to pay and price of next best alternative), therefore the rate of increase will differ per commodity and service over the forecasting period. Rail tariff increases projected for this project are a function of tariff increases as well as targeting an optimised mix of traffic resulting in the General Freight's total weighted average revenue per ton increasing year-on-year above CPI.

TRANSNET

3. "All the relevant Capital Expenditure associated with the project".

Further expansionary and sustaining investments supporting the locomotive investment is provided below and includes the following:

a. Investment proposed in the 1064 Business Case:

- Capital and other costs

  Capital cost outflows for the procured locomotives have been structured with a payment strategy similar to previous locomotive transactions. Basically 10% advance payment, 80% on delivery and then 5% each on reliability and availability efficiency levels achieved these are however subject to negotiation. Upfront costs of R250 million for diesel locomotives and R300 million for electric locomotives will be paid on signing the supplier contract and will be offset against the cost of the first batch purchased. The purchase price of both diesel and electric locomotives assumes a minimum of 55% local component for diesel and 60% for electric locomotives, with minimum premium for localisation capped at 2% of the purchase price.

- Wagon costs

  Costs were calculated based on the expansionary number of wagons required to achieve 170 million tonnes (16,459 wagons) based on the proposed capex budget in the Supporting Documentation Section E12 (Wagon Requirements). Opex and capex costs are incurred according to incremental volumes moved.

- Infrastructure costs

  Costs were calculated using the total required expansionary GFB infrastructure to deliver 170 million tonnes based on the latest corporate plan. Infrastructure capex costs are incurred according to incremental volumes moved.

b. Increase requirement in Wagon Fleet

The requirement for wagons is reviewed annually to meet the dynamic commodity mix. Approximately 85% of general freight tonnages are delivered by 18 of the 76 wagon types. Investment in specialised wagons to service key sectors, such as automotive, containerised and intermodal business as well as other major mining commodities (e.g. manganese, magnetite and domestic coal), which had previously not been made, are now proceeding.

c. Rail Network investments required to expand General Freight Volumes

Rail network capital expenditure focusses on the reduction of incidents, improved safety standards, optimal utilisation of slot capacity to execute traffic and constant focus on the modernisation of the network. Upgrades and replacements have been planned for the required restoration of the network to world class standards so as to reduce incidents, increase operational productivity and increase railed commodity tonnages.

TRANSNET

It should be noted that not all capital investment related to the acquisition of 1064 locomotives will require approval from the Shareholder in terms of Section 54 of the PFMA. A high level view of further expansionary and sustaining investments supporting the locomotive investment is contained in **Annexure C.**

4. **"Operational costs must be monitored and rigorously controlled throughout the lifespan of the project to avoid any cost escalations".**

TFR has established a Results Management Office ("RMO") as a mechanism to assist the TFR's Executive Committee to ensure that the Market Demand Strategy and all other key initiatives are executed as planned. The RMO is located in the Office of the Chief Executive Officer and is responsible to drive a TFR-wide business performance reporting and provide visibility across the strategy execution of projects in the portfolio and the impact thereof on achieving the MDS strategic objectives.

The TFR Finance Department together with the RMO will continually evaluate the 1064 locomotives project, monitor and track its progress against the MDS plan, as well as escalate and provide mitigation support for any potential risks constraining the successful achievement of this project. This will be achieved through:

- Performing quality and risk audits on the project to ensure that prescribed project execution standards are adhered to and risks are mitigated.
- Analysing the impact of changes in the external economic environment on project achievement in order to provide early warnings for implementation of mitigating strategies.
- Evaluating proposed benefits in order to provide an aggregated view of probabilities of target achievement.
- Continuous reporting of the project performance to all relevant stakeholders.

In addition to the abovementioned measures, Transnet's track record reflects excellent cost control as is evident in the latest interim financial results release, where operating expenses increase were mitigated through cost optimisation initiatives of R1,4 billion. Transnet has taken note of the National Treasury Instruction 1 of 2013/14 and has set in motion the cost containment measures contained in the Instruction Note across the Company.

National Treasury has indicated an interest in joining the Department of Public Enterprises during their quarterly engagements with Transnet specifically to discuss Transnet's capital investment programme and execution of the major infrastructure projects. The 1064 locomotive acquisition will be included as a project that is focussed upon during the engagement. Engagements with National Treasury in 2013 were conducted through the office of Ms Avril Halstead, Chief Director – Sector Oversight.

Lastly, we submit a quarterly report to National Treasury that covers Transnet's major investments, providing feedback on progress, reasons for deviation and spending against budget. This report is submitted to Lloyd Ramakobya and Luyulo Ntlangula from National Treasury. If required please advise additional names that may need to form part of our engagement sessions with National Treasury and the distribution list of the quarterly report.

TRANSNET

I trust you find the above in order, please do not hesitate to contact me should you have further queries.

Thanking you.

Kind regards

Mafika Mkwanazi
Chairperson
Date: 11/03/2024

CC: Minister Malusi Gigaba, MP
Minister of Public Enterprises

Annexure A

Road to Rail Migration Strategy

The Transnet Market Demand Strategy is premised primarily on the growth of General Freight traffic from ~83mt in 2012/13 to ~180mt in 2019/20 (Corporate Plan 2013/14) such that General Freight tonnages comprise close to 50% of total TFR tonnages (vs 40% in 2012/13). The intent of this strategy is to begin the process of shifting rail friendly traffic from Road to Rail. The procurement of new locomotives is a key element of this strategy. The strategy is starting to reflect signs of success as indicated by the slight increase in rail market share from 11.1% of tonnage and 29.3% of TonKm in 2010 to 11.5% and 29.9% respectively in 2012 (Source: 9th Annual State of Logistics Survey for South Africa 2012). Relative success is also reflected in the steady market share growth achieved by the Container and Automotive business unit:

	Total Ports	Long Haul
2011	13%	21%
2013	20%	31%

There are a number of drivers of the capital programme which is a decisive strategic intervention to eliminate legacy rail challenges. The primary objective is to modernise both General Freight rolling stock fleet and infrastructure network after decades of under-investment. This includes the strategy to modernise and standardise assets and includes the procurement of both diesel and new generation dual voltage electric locomotives to be deployed according to the network characteristics to achieve projected efficiencies and volume growth. General Freight commodities projected to reflect high growth over the seven years of the Market Demand Strategy are:

Growth Commodities

Commodity	Sector / Segment	CAGR
Iron and Steel	Bulk Mining & Manufacturing	20.8%
Export Coal (Non RBCT)	Bulk Mining Export	18.9%
Eskom Coal	Bulk Manufacturing	17.6%
Manganese Export PE	Bulk Mining Export	15.8%
Iron Ore	Manufacturing	15.1%
Chrome & Ferrochrome	Bulk Mining & Manufacturing	12.1%
FMCG	Beneficiated / Palletised / Containerised	10.7%
Agriculture	Bulk export / processing	9.94%
Mineral Mining	Bulk Mining & Manufacturing	9.8%
Automotive	Import/ Export	9.2%
Coal (Domestic other)	Bulk Manufacturing	6.6%
Industrial Chemicals	Bulk Manufacturing	5.9%
Wood & Wood product	Bulk Export / processing	5.7%
Fertilizer	Bulk Export / processing	4.6%
Intermodal wholesale	Beneficiated / Palletised / Containerised	4.6%

Annexure A

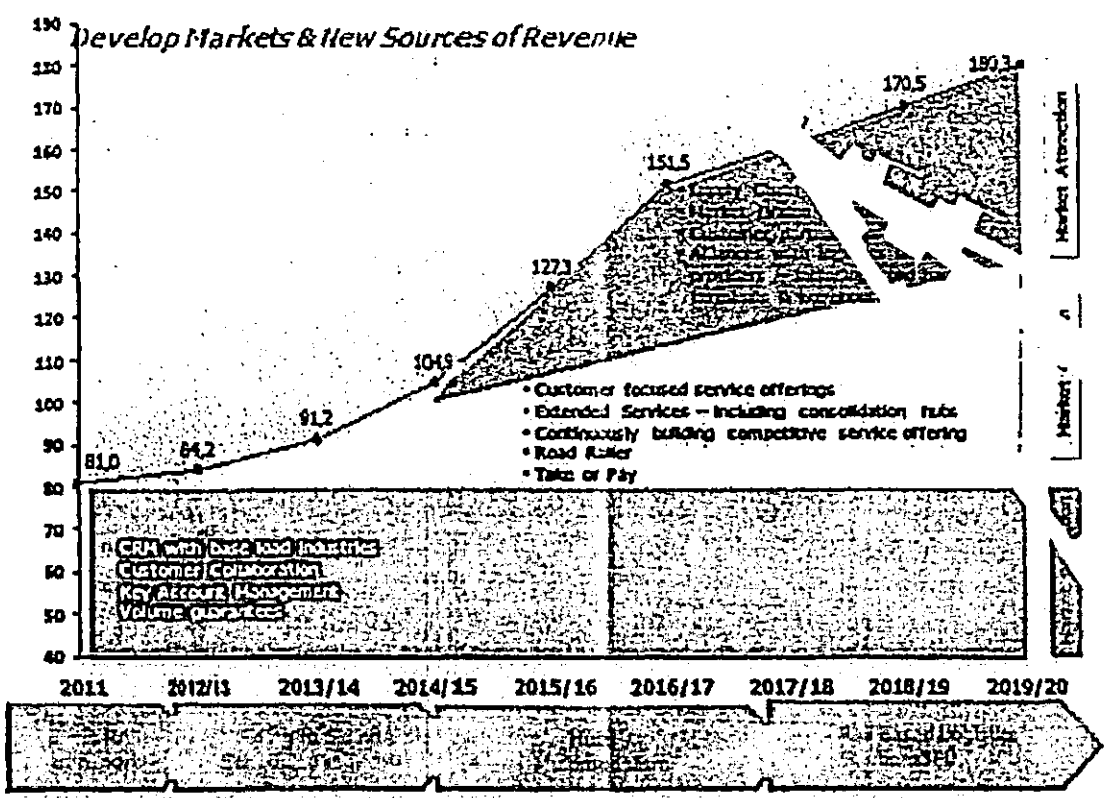
Commodity	Sector / Segment	CAGR
Cement	Bulk Manufacturing	4.3%
Bulk Liquids	Bulk Manufacturing	3.7%

The greater than GDP growth anticipated for some of the above listed commodities is due to:

- Existing excess demand now being captured by TFR
- New business development for junior miners
- Junior miner production growing at a faster rate
- Clients optimising the supply chain
- Improved services and efficiencies by TFR resulting in clients being able to produce and move greater volumes. Production used to be aligned to transportable capacity.
- Intermodal strategies and road to rail migration
- Over border traffic flows growing in the SADC region.

The graphic below is illustrative of the Road to Rail strategic journey in the growth of General Freight tonnage and market share.

Road to Rail Strategy for General Freight Volume & Market Share Growth



Annexure A

Market Retention: Retaining and sustaining current business

As a first priority, locomotives will be deployed to retain existing base load Siding to Siding General Freight traffic and to cater to the organic growth of existing customers. This retention requires significantly improved efficiencies to be achieved through reliability of service with improved throughput time. Transnet Freight Rail ("TFR") currently projects efficiency improvements of 29% to 37% due to the deployment of new locomotives. This is evidenced by the improvements already achieved on corridors where new locomotives have already been deployed:

- 60% efficiency improvement of the Class 43 Diesel locomotives from 5 000 000 to 8 000 000 GTK/Loco/month on the Phalaborwa-Richards Bay corridor
- The 19E locomotives deployed on the Export Coal corridor have achieved efficiency improvements of 18% (2011/12 – 2013/14 YTD). Similarly improvements of 28% have been achieved with the 15E locomotives on the Export Iron Ore line

The retention of existing traffic is the current focus and will remain core to the strategy over the time horizon of the MDS. Dual voltage electric locomotives will initially be deployed to critical flows such as:

- Postmasburg to Port Elizabeth (Manganese)
- Port Elizabeth to Kazerne (Containers and Cars), and
- Rustenburg to Richards Bay (Chrome and Ferrochrome).

This deployment of new locomotives will eliminate the need for lengthy stopovers on corridors to change locomotives and carry out brake and other safety related tests thus improving the reliability of services. The imperative to improve the execution and efficiency of these services is critical to building the goodwill of existing customers in order to gain increased percentages of their freight and to build the TFR service reputation in the marketplace. This is vital for the success of future Road to Rail shift strategies.

Market Growth

The next imperative in the Road to Rail shift strategy is to capture bulk mining and manufacturing rail friendly commodities that are currently being conveyed by road hauliers. This is the core competency of rail and must be exploited. Locomotives will thus be deployed to corridors and flows to achieve organic growth in such commodities as Eskom coal flows, magnetite, chrome and ferrochrome as well as earning the right to transport finished goods produced by existing customers, for example in the Steel and Cement industries. Due to retirement of older locomotives, additional locomotives will be required to facilitate this growth.

Market growth of agricultural products such as Grain, Maize and Wheat as well as Timber products will also contribute to Road to Rail shift. Older locomotive types will be cascaded as appropriate to consolidate traffic from Branch lines or other feeder areas to strategic

consolidation hubs where longer trains (e.g. 100 – 120 timber wagon trains) are built to transport product to ports for export or to mills for further processing.

Market Attraction: Collaboration and joint logistic solutions

Market attraction of new customers and / or new markets involves the development of inter-modalism or rail-based logistics services. Typical commodities to be targeted are Manufactured or beneficiated freight and FMCG cargo that can be containerised or palletised. This includes:

- Import, export and cargo destined for domestic or regional consumption moving between terminals or distribution centres;
- Finished goods e.g. Bagged cement, steel products, automotive and machinery parts, textiles, foodstuff increasingly require some form of intermodal solution.

It is likely that such growth will be achieved in the later years of the strategic plan. Plans are however, currently underway in preparation for attracting such markets. These market development initiatives include:

- Collaboration with Port Terminals for mass evacuation of containers by rail from the Port of Durban to inland destinations
- Development and implementation of car racks in April 2013 enabled the transport of cars to and from Isipingo and Point in Durban. This has facilitated the effective improvement of cars transported to Kaalfontein.
- Development of road-railer wagons as a prerequisite for seamless intermodal services. The prototype will be ready for testing in 2015 and will ramp up from this point on once tests are completed.
- Development of the Domestic Intermodal strategy initially focusing on a road to rail shift on Natcor and CapeCor. A number of long haul trains per day will be operated between consolidation hubs and "last mile delivery" will be done by road hauliers. (Cost will be determined by road distances and an integrated price will be a critical success factor). 18 E Locomotive will be cascaded into the Natcor from other areas. There will be increased utilisation of the locomotive types currently used on the CapeCor
- These services can be optimised by partnerships with road hauliers, freight forwarders, and terminal operators. In this regard, TFR has signed an MOU with Imperial Logistics and with Barloworld to enable the joint development of such solutions

Annexure B

1. Container and Automotive Business Growth Strategy

The Container and Automotive Business ("CAB") strategy for Container and Auto to meet and exceed the MDS targets is built on developing new flows from new and existing customers and increasing volumes on existing flows. This will be achieved through introduction of value propositions that will lock customers to provide TFR with first right of refusal and targeting growth segments within the container and auto markets. CAB's double digit growth has been achieved of 28% in the previous financial year 2012/13 and projected at 20% this financial year 2013/14, and future growth is projected at 10% to 15% through the MDS period. To support the increased demand, capacity creation projects have been initiated for upgrading and developing new terminals.

Market Strategy

The container markets have been segmented into Maritime (import and export) container market, Domestic and Overborder. The Maritime opportunity is the increasing trend of bulk minerals being containerised for export and developing stronger value propositions for the merchants to increase imports on rail. The Domestic market has untapped growth opportunities and this will be rolled out from 1st April 2014 upon the finalisation of the Domestic Intermodalism strategy. The automotive market capacity constraint has finally received some relief with the injection of new wagons and the focus can now be on increasing volumes through increased customer base:

- Natcor

Aggressive marketing of extra heavy container which was a growth area thus attracting increased containers packed with mineral mining for export on the Natcor.

- Export tonnage increase from the JHb complex from 10 100teus to 28 800teus (184% increase).
- All inland terminals were exceeding their design capacity City Deep 240000teus, Kascon 72 000teus and Pretcon of 50 000teus.
- JV's with private terminals SACD and Bridge to handle some of City Deep volumes during construction disruptions in 2013/2014 and 2015.

- Bloemfontein to PE

The "Common User Bulk Terminal" strategy was developed. Bloemfontein was previously moving 200 containers in a month now moves 200 containers per day and demand is 400 to 600 containers.

- Open top back tipping container

The introduction of the open top back tipping container that is now used for Eskom Tutuka coal and manganese from Lohatla. This concept has caught on and customers have bought

approximately 3000 of these containers over the past year to move iron ore and manganese. It is also to be used to rail chrome from Rustenburg to Newcastle.

Capacity creation investments to grow and sustain CAB volumes

The table below shows the approved capacity creation investment in the Natcor to grow and sustain CAB volumes:

City Deep	Investment of R900 million was approved to upgrade and increase terminal operating capacity from 240 000 teus to 400 000teus per annum. This is work in progress and project will be completed in 2015
Kascon	Investment of R78 million to increase capacity from 72000 teus to 150000 teus for phase one to be completed in 2014
Pretcon	Investment of R37 million to increase capacity from 50000 teus to 150000 teus
Bloemfontein	Investment of R66 million was approved to build new terminal from existing terminal which is in the middle of a suburb
Newcastle	Investment of R20 million to open new commodity flows to the Natcor, and to roll out the success of the "Common User Bulk Terminal" of Bloemfontein. This initiative started with domestic coal to Cape Town
Catoridge	To invest R60 million, which is still to be approved, to start the Catoridge Logistics Hub
Bayhead	Redesign of Bayhead yard with longer lines for longer trains, Capex still to be approved
Kingsrest	Rail yard buffer stack expansion to improve port rail efficiencies and rail capacity
Automotive	300 new wagons from TE with lights for night working. 143 to be returned defective lights and other workmanship issues
Lohatla	A "proof of concept" terminal was opened in Lohatla for R5 million and this created a demand that rail capacity cannot handle.

PSP capacity creation initiatives

The table below illustrates non-capex capacity creation initiatives:

Polokwane	Customer leased the site and expects this to increase volumes to Polokwane terminal
Richards bay	Future terminal is being considered
Bi-modalism	Investment by customers is in the final stages of tender process

2. Domestic Coal Growth Strategy

The next imperative in the Road to Rail shift strategy is to capture bulk mining and manufacturing rail friendly commodities that are currently being conveyed by road hauliers.

This is the core competency of rail and must be exploited. Achieving organic growth in commodities such as Eskom coal flows plays a vital role in modal shift from Road to Rail. Domestic coal's future growth is projected at 19% through the MDS period.

Market Strategy

The first biggest growth is Eskom 32 million ton with the upgrading of both infrastructure lines from the current 18ton axle to 26 tons axle to accommodate the huge increase to Majuba power station. This will also call for wagon wagons and substations upgrade. Grindrod Terminals also joined forces with RBT Resources (Pty) Ltd in 2012 by establishing a joint venture called RBT Grindrod Terminals (Pty) Ltd ("RBTG") with the intention of developing a 20 million ton export terminal on the Navitrade and an adjacent property. The immediate plans are for RBTG to begin construction of Phase 1 of the development in 2014 increasing the capacity 3 million to 5 million tons per annum.

Initiatives to grow volumes and improving market share

The table below shows the approved capacity creation investment to grow and sustain domestic coal volumes:

Eskom Supply Chain Optimisation	Migrate 80% of the current road hauled coal to rail by 2016/17
	Align coal demand with ramp up requirements for Majuba to 9mtpa by December 2014 • Re-commission Camden operation • Consolidate coal sources for Camden power Stations
Eskom Road-Change-Over Strategy	Review on / off loading times for optimal rail service
	Integration of planning process on Plato-Rail for all Exports and Domestic Coal load outs
	Centralised consolidation of key account plans
Maputo - 90% volume guarantees	Guarantee for Maputo volumes
Majuba power station enhancement	Create capacity to increase tonnages on rail through tippler upgrades, loading sites increase, introduction of longer trains from 60 – 75 wagons
	Rail Enabling Other Power Stations through the development of the rail infrastructure at the PS including removing railway lines from the network, offloading facilities i.e. tippler offloading, container offloading, bottom discharge offloading etc.
	Programme Implementation o Phase 1: Implement an interim container solution remove trucks off the road o Phase 2: All power stations to have tipplers in place as a permanent solution

Annexure C

Other Capital Expenditures associated with the project

A High level view of further Expansionary and sustaining investments supporting the locomotive investment is provided below and includes the following:

1. Investments proposed in the 1064 business case
2. Increase requirement in Wagon Fleet.
3. Rail Network investments required to expand General Freight Volumes.

1. Investments proposed in the 1064 business case

As per the extract from the 1064 Business case capital and other costs were considered

- Capital and other costs:

  Capital cost outflows for the procured locomotives have been structured with an aggressive payment strategy of 90 percent of the locomotive purchase is paid on delivery of the locomotive and 10 percent on acceptance. Upfront costs of R250 million for diesel locomotives and R300 million for electric locomotives will be paid on signing the supplier contract and will offset against the cost of the first batch purchased. The purchase price of both diesel and electric locomotives assumes a 50 percent localisation component, with a 2 percent localisation premium applied.

  In addition to modelling the capital costs for locomotives to be procured for the 1064, associated wagon and infrastructure costs have been allocated as per the 2013 Transnet Corporate Plan – the exhibit below shows the capital costs for diesel and electric locomotives, wagons, and infrastructure.

Exhibit 1 : Capital expenditure schedule

Capital expenditure schedule								
Rm Cashflow	PV	13/14	14/15	15/16	16/17	17/18	18/19	19/20
Diesels	8 314	2 433	2 552	2 709	2 881	2 064	0	0
Electrics	12 252	300	1 860	4 665	5 042	5 360	6 284	217
Wagon capex	10 017	3 022	3 417	3 462	3 228	2 559	649	0
Wagon copex	1 583	3	23	70	151	242	339	420
Infra capex	9 513	1 026	2 787	3 379	3 023	3 092	4 967	0
Infra copex	8 978	60	384	795	1 249	1 627	1 837	2 253
Total	50 656	6 844	11 023	15 079	15 575	14 944	14 075	2 890

- Wagon costs:

  Costs were calculated based on the expansionary number of wagons required to achieve 170 million tonnes (16,459 wagons) based on the proposed capex budget in the Supporting Documentation Section E12 (Wagon Requirements). Opex and capex costs are incurred according to incremental volumes moved.

- Infrastructure costs:

  Costs were calculated using the total required expansionary GFB infrastructure to deliver 170 million tonnes based on the latest corporate plan. Infrastructure capex costs are incurred according to incremental volumes moved.

2. Increase requirement in Wagon Fleet

The requirement for wagons is reviewed annually to meet the dynamic commodity mix. Approximately 85% of general freight tonnages are delivered by 18 of the 76 wagon types. Investment in specialised wagons to service key sectors, such as automotive, containerised and intermodal business as well as other major mining commodities (e.g. manganese, magnetite and domestic coal), which had previously been put on hold, are now proceeding.

3. Rail Network investments required to expand General Freight Volumes

Rail network capital expenditure focus remains the reduction of incidents, improved safety standards, optimal utilisation of slot capacity to execute and constant focus on the modernisation of the network. Upgrades and replacements have been planned for the required restoration of the network to world class standards so as to reduce incidents, increase operational productivity and increase railed commodity tonnages. Key network programmes for replacement of the signalling system (communication-based train control), the upgrade and replacement of the telecommunication backbone, rail replacement for feeder lines on the heavy-haul lines and major sections of the core general freight network to meet recommendations by Deutsche Bahn for a safe and world-class railway.

Annexure C

High level view of Strategic Expansion projects dependent on the locomotive investment are tabled below:

Overview: Strategic Expansion Projects

Project	Description	PLP milestones	Volume ramp up and expected due date
Waterberg Phase 2-6	A five- stage scalable upgrade of the existing line from Lephalale to Ogies planned initially based on 100 wagon head-end trains with a switch over to 200 wagon, distributed power trains by 2016/17.	Investments are staggered and two separate investment cases (FEL 3/4) will be submitted.	Incremental capacity increases against respective stage completion to a maximum of 27Mtpa will be provided by 2018/19.
Waterberg Heavy haul line	A new ~450 km heavy haul line linking in south of Thabazimbi to the Broodsnyersplaas area will be developed to meet demand beyond 27 mtpa and support the augmentation of export coal from the Mpumalanga coalfields with coal from the Waterberg and Botswana.	FEL 2: 2014/15 FEL 3: 2015/16 FEL 4: 2016/17 start	The design of the line will follow the Ore line expansion with the provision of a 26 tons/axle electrified single line with evenly spaced passing loops. Initial capacity of ~40mtpa can be provided, scalable to 80mtpa by building intermediary passing loops. The new line is currently not funded. The construction of the new line, once approved, will take approximately 5 years
Coal Backbone	The coal backbone is the common denominator of the coal system and acts as the conduit for coal flows from Mpumalanga as well as 'transit' volumes from the Waterberg for Eskom in support of the 32mtpa rail migration programme or exports and the new Majuba Coal Transport System (CTS) line.	FEL 2: 2014/15 FEL 3: 2015/16 FEL 4: 2016/17 start	Timing of capacity depends largely on Eskom's long terms sourcing strategy. An increase in volumes from Waterberg requires the upgrade of rail line from Ogies to Lephalale, whereas sourcing coal in Mpumalanga requires upgrading of the coal feeder lines between Ogies and Ermelo.
Coal 91	Coal 91: Incorporates a combination of significant capital expenditure and operational optimisation initiatives to increase the overall coal export system	FEL 2: 2014/15 FEL 3: 2015/16 FEL 4: 2016/17	Volume ramp up will be determined on completion of the demand validation exercise.

Annexure C

Project	Description	PLP milestones	Volume ramp up and expected due date
	capacity to 91+ mtpa.		
Botswana link	Provides access to Botswana	FEL 2: 2014/15 FEL 3: 2015/16 FEL 4: 2016/17	
Overvaal tunnel doubling	The Overvaal tunnel is situated between Overvaal and Mavirlstad stations south of Ermelo and is the only single line section on the coal line between Ermelo and Richards Bay. The project will provide a new, double shaft tunnel adjacent to the existing tunnel built in 1976.	FEL 3: 2013/14 start FEL 4: 2014/15 Q4 start	Although the doubling of the tunnel will provide inherent capacity, the primary reason for the investment is safety and risk related.
Swazi link	The Swazi link project introduces the first regional integration project that will stimulate intra-regional trade and exports through the building of a 146km new link line connecting the South African and Swaziland networks from Lothair to Sidvokodvo (Swaziland). The project includes operationalisation and upgrading of supporting links to general freight standards such as the Lothair branch line and the Sidvokodvo to Phuzumoya line in Swaziland	FEL 3: 2014/15 FEL 4: 2015/16 start	On completion, the project will initially provide capacity to divert ~14mtpa of general freight from the export coal corridor
Manganese to 16mtpa	Manganese export capacity from 5.5Mtpa (currently offered through the Port of Port Elizabeth) to 16Mtpa from the Northern Cape via a new export facility in the Port of Ngqura is one of the key development initiatives in Transnet.	FEL4: In progress	12mtpa annualised capacity to be provided by 2018/19.

Annexure C

Project	Description	PLP milestones	Volume ramp up and expected due date
Iron Ore line	Expansion of the ore line corridor from Sishen in the Northern Cape to Saldanha	FEL 2: 2014/15 FEL 3: 2015/16 start.	Iron ore volumes in the MDS will be revisited once the validation process has been finalised

Appendix 45 868

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TRANSNET

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MEMORANDUM

To: Transnet Board of Directors (BOD)

From: Brian Molefe, Group Chief Executive

SUBJECT: INCREASE IN ESTIMATED TOTAL COST (ETC) OF THE ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET FREIGHT RAIL'S GENERAL FREIGHT BUSINESS (GFB)

PURPOSE:

1. The purpose of this memo is:
   a) for the BOD to note the reasons for the increase in ETC.
   b) to request that the BOD approve an increase in the estimated total cost (ETC) for the acquisition of 1064 Locomotives for the General Freight Business of Transnet Freight Rail from R 38.6 billion to R 54.5 billion.

EXECUTIVE SUMMARY:

2. In summary the increase in ETC of R 15.9 billion can be attributed to the following:

Update of business case for updated economic factors	R 5.4 bn	34 %
Risk Mitigation - Forex and Escalation	R 9.5 bn	59 %
TE Scope	R 2.6 bn	16 %
Contingencies	R 4.9 bn	31 %
Lower capital acquisition cost of the locomotive obtained through the competitive tender and negotiation process less the batch pricing adjustment of R 2.7 billion.	R – 6.5 bn	- 41 %

3. 93 % of the ETC increase relates to changes in market conditions and the risk tolerance level of the company. Whilst 16 % of the ETC increase relates to strategic factors such as localisation and competition. These increases have been offset by a competitive tender and negotiation process that realised a benefit of 41 %.

4. On a like for like comparison the new price including TE scope of R 40.09 billion (excluding hedging and escalation) is only 3.89 % higher than the approved ETC of R 38.6 billion. The balance of the ETC increase relates to risk mitigation and strategic

concessions such as batch pricing.

5. Regiments Capital (using an international expert) benchmarked the Capital Acquisition Cost of the locomotives at the "best and final offer" stage of this transaction and the results indicate that the price being offered by the bidders is reasonable. Given that forex, escalation, economic factors and batch pricing impact is subject to market conditions it can be deduced that the final contract price is also reasonable.

6. The need to incur these costs has been justified and the associated costs are reasonable in the circumstances.

7. The NPV of the business case remains positive at R 11.68 billion.

8. Impacts on the 2014/15 corporate plan has been assessed and mitigated. Consequently the R 54.5 billion is affordable and reasonable.

9. Risk mitigation measures have been developed and are being implemented to ensure benefits are realised.

10. Significant socio economic benefits such as localisation and job creation will be realised.

11. Significant benefit will be achieved by the company including additional volumes earlier, additional cash flows, a stronger balance sheet, which should enable greater capital expansion in future.

12. This acquisition in conjunction with other locomotive acquisitions will significantly contribute towards the company achieving its original MDS targets of 350 mt by 2018/19 and consequently is fully aligned with the MDS of the company.

13. The strategic, commercial and socio economic benefits associated with this acquisition will significantly outweigh the capital cost.

BACKGROUND:

14. The acquisition of 1064 Locomotives was approved by the Board of Directors in April 2013 at a cost of R 38.6 billion. This excluded the following costs:

    a. The cost of changes in economic conditions (forex and inflation) between approval of the business case and award of the contracts
    b. The cost of hedging for foreign exchange movements;
    c. The cost for future inflationary escalations;
    d. The cost of additional scope for Transnet Engineering (TE);

15. The rationale for the investment is to increase the capacity of TFR's GFB from 80mt to 180mt in terms of the Market demand Strategy (MDS).

16. The acquisition of 1064 Locomotives for GFB was approved by the Shareholder Minister (Department of Public Enterprises) on 3 August 2013.

17. Although the approval from the Minister was not subject to a final cost of R 38.6 billion, for good governance and for information purposes a letter will be sent to the DPE

advising of the final ETC.

18. Four contracts to acquire 1064 locomotives were concluded on 17 March 2014 at a cost of R 49.5 billion Including the cost of future escalations, Including additional scope for TE and Including foreign exchange hedging costs thus resulting in an increase in ETC of approximately R 15.9 billion (including a 10 % contingency).

19. As per the DTI codes for local content, the tender process required that bidders exceed a minimum Supplier Development (SD) threshold of 40 %. All bidders exceeded this threshold. All the bidders met the minimum thresholds for local content of 55 % for diesel locomotives and 60% for electric locomotives.

20. The locomotives will be delivered at a rate of 12 locomotives per month per bidder at peak production as per the summarised delivery schedule below (refer Table 1). In order to mitigate against late delivery risk, a penalty regime capped at 10 % of the contract price has been agreed to with all bidders.

Table 1

Delivery Schedule - Diesel Locomotives	CNR	GE
	232 (50%)	233 (50%)
	CNR 1st 20 from China	GE 1st 6 from USA
by March 2015	0	0
by March 2016	20	34
by March 2017	87	126
by Oct 2017	84	73
by February 2018	42	
Locomotives will be manufactured at a peak tempo of 12 per month.		

Delivery Schedule - Electric locomotives	Bombardier	CSR
	240 (40%)	359 (60%)
	BT produce all loco's locally	CSR 1st 40 from China
by March 2016	6	88
by March 2017	137	142
by December 2017	97	
by January 2018		129
Locomotives will be manufactured at a peak tempo of 12 per month.		

DISCUSSION

21. In order to analyse the increase in ETC two factors need to be considered:

    i. Updated economic data from business case date to current (backward looking);

    ii. Future financial risks emanating from the transaction and costs associated to mitigate these risks (forward looking).

22. This document has been prepared to explain the increase in ETC on this basis, concentrating on why these costs needed to be incurred and were these costs reasonable in the circumstances.

23. The increase in ETC of R 15.9 billion is due to the following reasons (refer Table 2 below):

    a) Escalations from the approved business case to award date (backward looking) (Item A of Table 2)

    b) Forex from the approved business case to award date (backward looking) (Item C of Table 2)

    c) Additional scope of work allocated to Transnet Engineering (TE) for the strategy to enable TE to eventually transform to an Original Equipment Manufacturer (OEM) of locomotives (strategic) (Item B of Table 2).

    d) The cost of reducing the batch size (strategic and risk mitigation) (Item D of Table 2)

    e) The cost of future escalations over the life of the contract (forward looking and risk mitigation) (Item E of Table 2)

    f) The cost of fixing forex exposure over the life of the contract (forward looking and risk mitigation) (Item F of Table 2)

    g) Contingencies related to variation orders, options (such as electronically controlled pneumatic braking and wire distributed power etc.) and capital spares (Item G of Table 2)

Table 2

		Diesel / Electric Grand Total R 1 064	%
Best and Final Offer per Board submission excluding Hedging & Escalation		29 333 832 740	
Adjusted for changes to:		9 954 929 119	
Escalation up to signature date (from close of tender to Mar 14)	A	2 362 018 109	8.0%
Add back original TE scope removed for BAFO purposes	B	1 706 643 360	5.8%
Forex adjustment to spot rate at 17 March 2014	C	3 030 660 144	10.3%
Batch pricing adjustment for reduction of batch size to 40 % / 60 %	D	2 754 402 335	9.4%
Best and Final Offer updated for economic and other factors		39 288 258 683	
Adjustments for: Additional TE Scope	E	839 172 732	3.0%
New Price including TE scope		40 052 429 415	
Cost to fix escalation to end of contract	E	6 725 748 499	16.8%
Cost of Hedging	F	2 729 046 496	6.8%
Estimated Total Cost including Hedging and Escalation		49 847 224 410	
The ETC above excludes the cost of any options, variations capital spares, initial spares, tools and test equipment. Add approximately a further 10 % at least to cover this cost.	G	4 554 775 590	
Proposed Estimated Total Cost including Hedging, Escalation, options, spares, tools and test equipment		54 402 006 000	

Increase in ETC for 1064 GFB Locomotives

BACKWARD LOOKING ECONOMIC AND OTHER FACTORS THAT HAVE IMPACTED THE PRICE:

24. The estimates and assumptions on which the 1064 business case was based have changed substantially since approval was obtained from the Transnet Board in April 2013.

25. In addition a number of parameters have materially changed since issue of the tender, approval of the investment by the Transnet Board and the contract negotiation process. These are summarised in Table 3 below:

Table 3

	Business Case	Tender Stage	Negotiation/ Contracting Stage	% movement
Rand to the US Dolar	9.13	8.98	10.72	19.4%
Rand to the Euro	n/a	11.86	14.87	25.4%.
Local CPI	n/a	100%	106.10%	6.1%*
Local Hot roled Steel plates Index	n/a	100%	112.90%	12.9%*
Local PPI	n/a	100%	107.50%	7.5%*
Chinese Equivalent CPI Index	n/a	100%	102.50%.	2.5%**
US Equivalent CPI Index	n/a	100%	101.33%	1.3% **
Euro Equivalent CPI Index	n/a	100%	102.08%	2.1%**

* Index movements calculated from Dec 12 to Jan 14
** Index movements calculated from May 13 to Mar14

Item C of Table 2

a. Foreign exchange rates. The Rand has depreciated by 19.4 % against the US Dollar since the tender stage. Similarly the Rand has also depreciated by 25.4 % against the Euro over the same period. The spot rate of exchange used in the business case to calculate the base price of the locomotive was 9.13 Rand to the US Dollar, as compared to the spot exchange rate as at contract signature date of 10.72 Rand to the US Dollar, an increase of 17.4 %. This has impacted the expected price of the locomotive as per the siness case and ultimately the ETC as approved by the Board.

Consequently the additional 3 % per C in Table 2 is reasonable.

Item A of Table 2

b. Labour cost increase. The cost . abour required to build the locomotives has increased locally within South Africa and globally over this period, as indicated within the CPI/PPI indices listed in Table 3 above and as evidenced by the higher than CPI wage settlement that Transnet entered into at 8.5 % for a 2 year period. Due to the tender localisation requirements, Transnet Engineering (TE) will assemble the locomotives and consequently local labour will be utilised for the assembly.

c. Material cost increase. A significant component of the locomotive is steel. The price of steel is impacted by the steel commodity price of which the trading currency is in

US Dollars and secondly thereby foreign exchange deterioration as well. The local index for hot rolled steel plates has deteriorated by approximately 12.9 % since December 2012, which is indicative of the level of increase in the price of steel.

d. Inflation. Local Producer Price Index (PPI) has increased by over 7.5 % since December 2012 thereby affecting the price of locally sourced products required for the build of the locomotives. Foreign equivalent indices also increased over this period. This together with the foreign exchange deterioration indicated above has resulted in the price of imported components for this project increasing.

e. Statistics SA report that the headline CPI annual inflation rate in April 2014 was 6.1 %, further explained in the Business Day article "CPI breaches Reserve Bank target" dated 22 May 2014.

f. Applying the relevant proportion of each of the labour, material and other input costs which make up the basket of items required for the manufacture of the locomotives, would result in the net increase in the locomotive price of 8 %.

g. Consequently the net impact of 8 % on the locomotive price due to the change in economic conditions as per item A of Table 2 is reasonable.

FORWARD LOOKING ECONOMIC FACTORS AND MEASURES TO MITIGATE FINANCIAL RISK THAT HAVE IMPACTED THE PRICE:

Forex (Item F of Table 2)

26. The Financial Risk Management Framework (FRMF) approved by the Board of Directors (BOD) does not permit Transnet accepting forex exposure on committed transactions.

27. The South African Reserve Bank (SARB) also does not permit SOC's to accept open exposure on foreign currency contracts.

28. In addition credit rating agencies and bond holders both prefer conservative risk appetites and consequently would also support fixing our forex exposure.

29. Sensitivities indicate that a 5 % devaluation of the Rand could impact the total ETC by approximately R 3.07 billion if left unhedged.

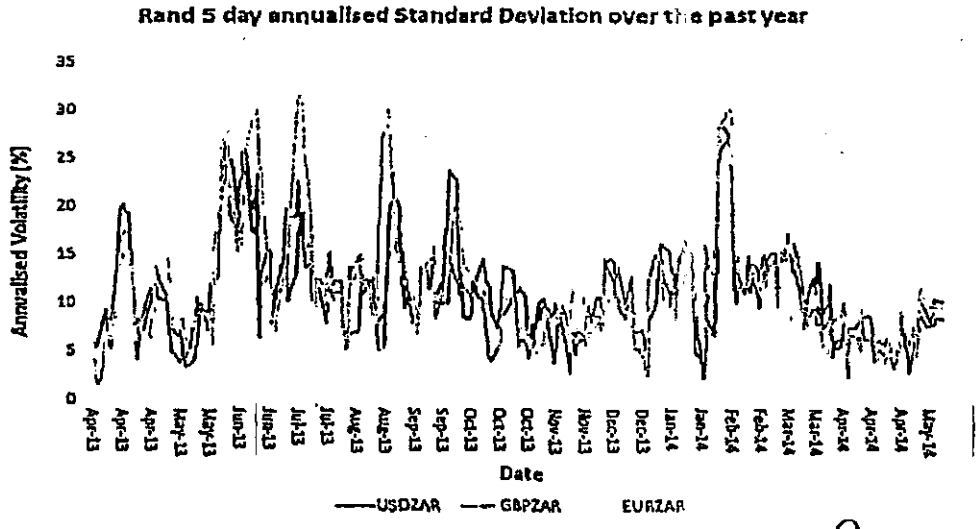
30. Consequently the cost of foreign currency hedging to mitigate and protect the Company against foreign currency devaluation is an inherent cost of the transaction.

31. Costs related to forex are influenced by market forces which are not within managements control and therefore were not included in the ETC for the business case submission. The impact of these forex related costs would only be known once the contract was negotiated and finalised as they are based on market conditions and sentiment at the time.

32. The cost of fixing the forex exposure is impacted by currency volatility and time or duration of the exposure.

33. The recent volatility in the foreign exchange rate of on average up to between 15 & 20 % directly impacts the transaction cost as can be seen in Table 4 below:

Table 4

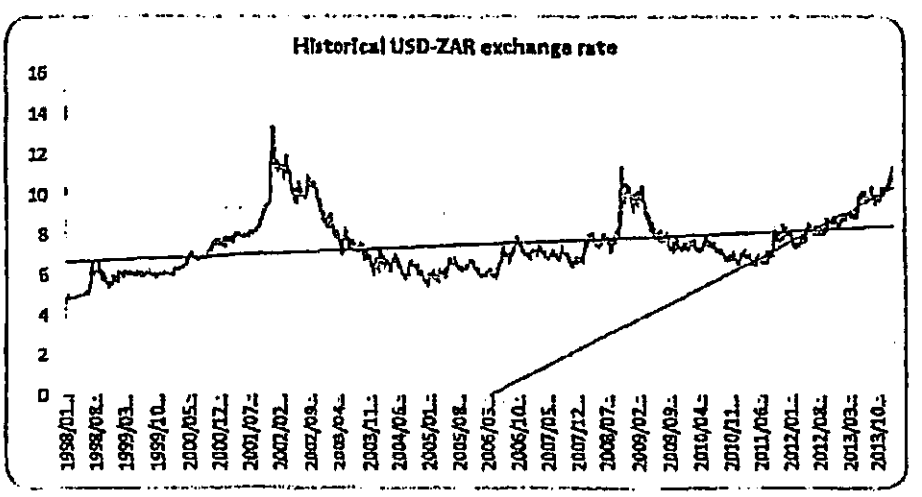


34. In addition the ZAR currency is one of the most volatile and fragile currencies in the world. This view is substantiated by the ZAR currency being termed as one of the "fragile five" by economists and financial markets (refer diagram below).

35. Business Day reported on 18 March 2014 that the Rand is in for a "Rocky ride" for the rest of the year (Refer article "Rocky Ride forecast for 'still to expensive' Rand)

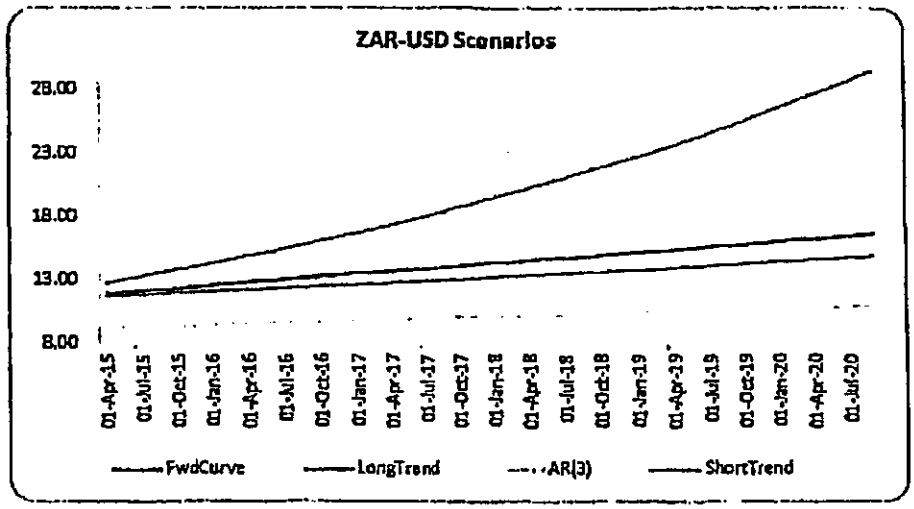
36. The generally held consensus view is that due to the twin deficit of the RSA budget and the current account, and the weak economic outlook supports Rand devaluation in the medium to long term.

Table 5



37. A historical regression analysis conducted by Regiments Capital indicates that the ZAR currency is on a trend of devaluation as indicated in Table 5 above.

Table 6



38. In addition Regiments Capital conducted various currency trend scenarios as indicated in Table 5 above. All scenarios indicate a general devaluation in ZAR over the medium term.

39. The imminent risk of the Ukraine crisis and its impact on emerging markets also had an impact on the decision to fix the exchange rate exposure.

40. In addition the delivery schedule of the locomotives, between 31 and 35 months, also impacts the cost of hedging as the length of the exposure impacts the costs. The longer the period the higher the premium paid due to unknown outcomes in the future.

41. Alternative methods, such as call and put option structures, to reduce cost and mitigate against forex exposure risk were explored in conjunction with Regiments Capital including methods in which Transnet would participate in any possible upside in Rand movements. These methods were evaluated from a cost benefit perspective and consequently the FEC route proved most beneficial and practical to mitigate forex risk.

42. In addition the accounting treatment of options was not optimal as per opinion obtained from KPMG as it would result in the creation of an embedded derivative.

43. The cost to hedge this exposure was obtained from banks by the suppliers. This was then vetted by Transnet Treasury and Regiments Capital for reasonability. They both found the rates and cost to be acceptable.

44. Consequently the net 6.8 % per F in Table 2 above is reasonable.

Escalation of Input Costs (Item E of Table 2)

45. Given the size, magnitude and risk tolerance of the company due to MDS execution, cash flow certainty is of paramount importance when trying to plan over a long term horizon.

46. This ensures that the company is able to manage its key financial metrics such as gearing, cash interest cover and the A/B ratio (required by rating agencies)

47. In addition credit rating agencies and bond holders both prefer conservative risk appetites and consequently would also support fixing our escalation exposure.

48. Careful consideration had to be given to accepting other risks such as labour, steel etc. and being exposed to market conditions.

49. Consequently it was decided to fix escalation for these input costs and gain certainty of cash flows.

50. Costs associated with fixing these input costs are largely driven by market sentiment at the time of contracting such as the items mentioned below.

51. Labour unrest and strikes in the platinum sector has put significant pressure on forward looking labour costs. As indicated earlier Transnet is subject to an 8.5 % wage adjustment for the 2014/15 financial year.

52. The contractor has also built a risk premium into their pricing for forward looking inflation, to cater for the unpredictable nature of the labour environment within South Africa and the risk associated with TE carrying out this additional *new* scope of work.

53. Statistics SA reports that the headline CPI annual inflation rate in April 2014 was 6.1 %, and which is further explained in the Business Day article "CPI Breaches Reserve bank target" dated 22 May 2014.

54. The SARB and National Treasury 2014 Budget Review forecasts CPI at 6.2 %, 5.9 % and 5.5 % for the years 2014, 2015 and 2016 respectively.

55. The MPC also is concerned about upward inflationary pressure on the economy as they have increased the Repo rate by 50 basis points recently in response to managing the upward inflationary pressures. Another imminent increase is highly likely at the next sitting of the MPC on 22 May 2014.

56. The high level of local content (60%) makes local indices more applicable to assess the cost of escalations going forward.

57. Applying the relevant proportion of each of the labour, material and other input costs which make up the basket of items required for the manufacture of the locomotives, would result in the net increase in the locomotive price of 9.2 % for electrics and 6.3 % for diesels increase.

58. Hence a CPI of 6 % escalated for 35 months on a compound basis (excluding a premium for risk) results in a 18.54 % increase, thus the net 16.8 % per E in Table 2 above is reasonable.

59. Escalations of input costs have been verified by Transnet by using publicly available data and by Regiments Capital using their intellectual property methodology and techniques.

TE Scope (Item B of Table 2)

60. A strategic decision was taken at a Transnet level that TE should transform to eventually become an OEM of locomotives. This 1064 tender process, together with the 100 equivalent 19E Dual Voltage Electric locomotive process, was used as a catalyst to facilitate this strategy.

61. As such bidders were advised to provide pricing based on providing TE with additional scope for the manufacture of the locomotives.

62. Strategically it was decided that for specific items within the build process where TE were within 10 % of the market price then it would be acceptable to allow TE to retain this scope.

63. The pricing as reflected above in Table 2 is inclusive of this additional scope for TE based on this principle.

64. Bidders have also built a risk premium into their pricing, to cater for the risk associated with Transnet Engineering carrying out this additional *new* scope of work for the 1st time.

65. Consequently the net additional 3 % per B in Table 2 is justified and is reasonable.

Batch Size (Item D of Table 2)

66. As approved by the Transnet Board the preferred bidders were advised that the batch size has been split on a 50/50 basis for the Diesels and a 60/40 basis for the electrics, amongst them.

67. This was done to mitigate locomotive delivery risk and reduce the MDS risk related to volumes.

68. As a result, the fixed costs related to setting up the production line would have to be recouped over a smaller batch.

69. This resulted in an increase in the cost per locomotive.

70. Although the cost per locomotive has increased, an overall saving is realised due to splitting the batch, because of the saving made on future escalations and hedging costs as a result of a shorter delivery period. This has been quantified to be R 4.08 billion.

71. Consequently the net additional 9.4 % per D in Table 2 is justified and is reasonable.

Contingencies (Item G of Table 2)

72. The contracted price of R 49.5 billion excludes the cost of any requirements for capital spares beyond the warranty period, variation orders and options (such as electronically controlled pneumatic braking and wire distributed power etc.) and as such an additional 10 % (R 4.9 billion) has been added into the request for additional ETC for this (refer item G of Table 2)

73. In order to stimulate development in other parts of South Africa, Transnet have decided that it would be more strategic to have two OEM's manufacture the locomotives in Durban.

74. In addition TE production lines in Koedoespoort cannot accommodate four OEM's as validated by the PWC study.

75. Bidders have based their contracted prices on manufacturing operations being carried out in Gauteng. Bidders have not yet quantified this cost, however this cost is included in the additional 10 % (refer item G of Table 2).

FINANCIAL IMPLICATIONS:

76. The business need and rationale remains as originally indicated in the business case submission.

77. The Business case resulted in a positive NPV (R2.7 billion at the TFR hurdle rate of 18.56 % and R34.1 billion at the TFR WACC of 12.56 %).

78. The Transnet hurdle rate has since been amended to 15.2 % and the NPV at this hurdle rate using the business case assumptions would be R 16.02 billion.

79. The financial models for the Business case have been updated for the following based on the conditions per the signed final contracts:
    a. Final pricing
    b. Revised cash flow profile for the capital investments
    c. Commensurate changes to the volume ramp up and tariff increases on commodities that are priced relative to the investment outlay

80. The updated NPV result is a positive NPV of R 11.68 billion at the new hurdle rate of 15.2 % and R 22.71 billion at the TFR WACC of 12.6 %. The NPV would become a negative R 1.67 billion at the original hurdle rate of 18.56%.

81. The WACC and hurdle rates are updated annually for changes in economic conditions and are approved by Transnet Exco and reviewed by External audit during the year end audit process.

BUDGET IMPLICATIONS:

82. The investment is included in the 2014/15 seven year capital investment plan.

83. The contracted delivery schedule and cash flows have changed as compared to the investment included in the 2014/15 seven year capital investment plan.

84. In order to ensure that Transnet's approved key affordability limits (gearing and cash interest cover) are not breached, a capital prioritisation process will be undertaken, such that other investments which do not impact MDS volume targets would be deferred.

85. The difference between the 2014/15 seven year investment plan and the projected cash flows based on the supplier agreements with contractors with an additional 10 % added for options, variation orders, special tooling, test equipment, initial spares and capital spares, is illustrated in Table 7 below:

Table 7

	Rand million								
	ETC	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21
Budget per Corporate Plan	41 468	-	315	4 188	8 344	9 123	9 420	8 382	1 696
Contracted	49 547								
Add 10 % for options, variations, tools, spares etc.	4 955								
Expected	54 502	4 824	6 308	6 597	18 618	16 970	1 185	-	-
Difference	-13 034	-4 824	-5 993	-2 409	-10 274	-7 847	8 235	8 382	1 696
Corporate Plan alignment to Business Case	-2 868								
Net ETC difference	-15 902								

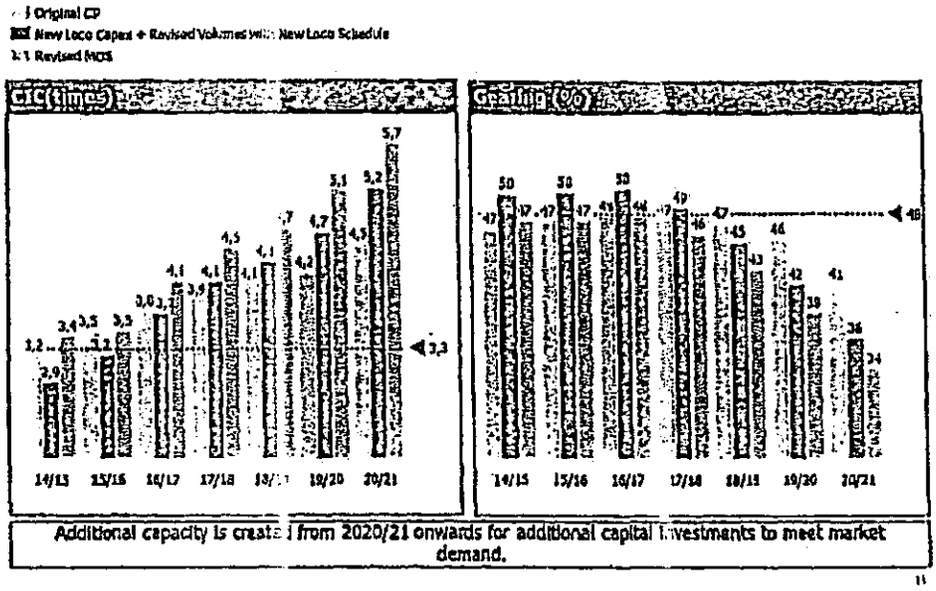
86. In order to secure accelerated delivery of the locomotives to address the MDS volumes at risk, a larger advance payment (R 4844 million) had to be made to the contractors in the 2013/14 financial year.

87. As confirmed by a letter received from the suppliers this was required by the suppliers in order to cover costs to ensure quicker delivery. The rationale as explained by the supplier was confirmed reasonable by Transnet's external auditors and was capitalised accordingly in the Financial Statement at 31 March 2014.

88. Although the accelerated delivery schedule would have resulted in earlier cash outflows for Transnet, an overall saving is realised because of the saving made on future escalations and hedging costs as a result of a shorter delivery period

89. The impact from the locomotive acquisition on the 2014/15 corporate plan as well as the impact of the prioritisation process; updating for the change in volumes, revenue, EBITDA and capital due to the combination of the 100 electric locomotives, 1064 locomotives and 60 Diesel locomotives contracts is reflected in the graph below:

Increase in ETC for 1064 GFB Locomotives



Additional capacity is created from 2020/21 onwards for additional capital investments to meet market demand.

90. As can be seen from the graphs the initial two years of the 2014/15 Corporate Plan has been negatively impacted the by locomotive acquisitions.

91. However after the planned EBITDA and optimisation initiatives that have been factored into the model the ratios are restored.

92. The initiatives identified to meet the Corporate Plan targets are detailed in Annexure A.

RISK MANAGEMENT:

93. In order to manage risks associated with this transaction a risk management framework is in the process of being developed.

94. A Locomotive Steering Committee has been set up to manage the operational issues associated with the locomotive acquisition and will address the following risks:

- Locomotive delivery
- The wagon build program
- Infrastructure requirements
- Operational readiness
- Commercial and Volumes

95. A socio economic monitor will be appointed to ensure socio economic benefits will be realised.

96. In order to mitigate against late delivery risk, a penalty regime capped at 10 % of the contract price has been agreed to with all bidders.

97. Escalation risk has been mitigated by fixing the price of the locomotives.

98. Forex risk has been mitigated by hedging the price of the locomotives by using the suppliers balance sheets.

99. All advance payments are secured by an on demand advance payment guarantee issued by a bank with a minimum long term credit rating of an A- Fitch rating or equivalent.

100. Payment terms have been structured such that the bulk of payments, of between 70 % and 90 %, happens after delivery of the locomotives.

101. In order to manage the total cost of ownership and mitigate against the risk that the locomotives once placed into operation will consume more fuel (diesel locomotives) or energy (electric locomotives) than indicated in bidders responses to the RFP, a penalty clause with a related fuel/energy warranty regime has been included in the supply agreement with bidders.

102. In order to mitigate against default of Supplier Development (SD) commitments, and SD penalty clause has been included in the supply agreements with bidders. An SD bond has also been obtained to cover risk against default.

103. GE have agreed to provide a 30 month warranty on the locomotive as well as a 6 year warranty on the traction motor and a 12 month warranty on spares.

104. CNR, BT and CSR have agreed to provide a 24 month warranty on the locomotive as well as a 6 year warranty on the traction motor and a 12 month warranty on spares.

105. A liability cap of 15 % of the contract price is included in the supply agreement thereby limiting Transnet's exposure in the unlikely event of breach of contract by Transnet.

106. In order to mitigate against the risk of having to accept and pay for locomotives during an economic downturn when volumes from customers may not be forthcoming thereby impacting negatively upon Transnet's loan covenants, bidders agreed to accept a clause in the supply agreement whereby acceptance of locomotives could be deferred for a period of time. Transnet agreed that in return bidders would be reimbursed for reasonable and auditable costs. These costs could include warehousing costs, time value of money costs, costs related to the rolling or hedges etc.

SOURCE OF INFORMATION AND REFERENCES.

107. Data quoted in the memo above has been sourced from:

- Statistics South Africa – release P0141
- Business Day 22 May 2014 – "CPI Breaches Reserve Bank target"
- Business Day 18 March 2014 – "Rocky Ride forecast for still too expensive Rand
- Reserve Bank and National Treasury 2014 Budget Review
- Regiments Capital (transaction advisory services)
- KMPG (accounting opinions)
- PWC (locomotive localisation opportunities for TE and South African Industry)

RECOMMENDATION:

108. It is recommended that:

a) the BOD take note that the main reasons for the increase in ETC is due to the exclusion of the following costs from the 24 January 2014 submission:

i. The cost of hedging for foreign exchange movements;
ii. The cost for future inflationary escalations;
iii. The cost of additional scope for Transnet Engineering (TE);
iv. The cost of changes in economic conditions (forex and inflation) between approval of the business case and award of the contract

b) the BOD approves an increase in estimated total cost (ETC) for the acquisition of the 1064 locomotives for Transnet Freight Rail's General Freight Business from R38,6 billion to R54,5 billion.

Recommended by:

Anoj Singh
Group Chief Financial Officer
Date: 22/05/14

Recommended by:

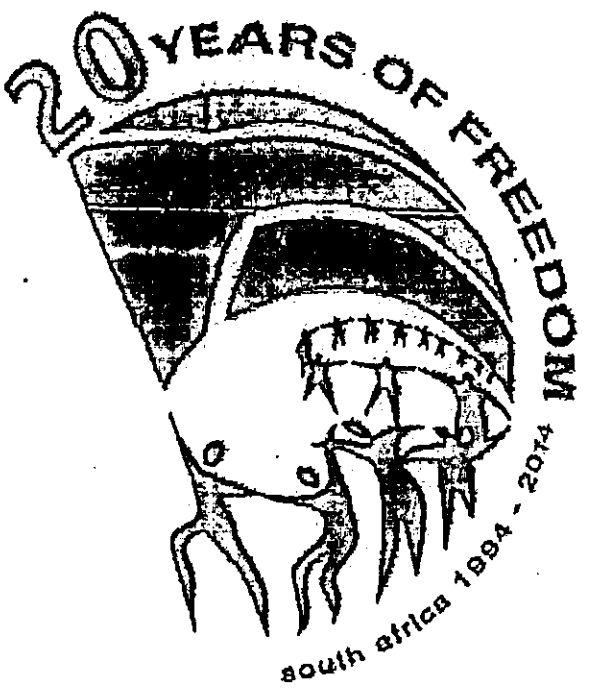
Siyabonga Gama
TFR Chief Executive
Date: 2014-05-21

Recommended by:

Brian Molefe
Group Chief Executive
Date: 23.5.14.

Locomotive tender for the supply of 1064 new locomotives for the Transnet Freight Rail General Freight Business

Report of the Finance Negotiation Team
to
Siyabonga Gama (TFR CE)
Anoj Singh (Transnet GCFO)



Key outcomes from the negotiations for the acquisition of 1064 new Locomotives concluded in March 2014

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Table of Contents

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Purpose

The purpose of this report is to detail the key financial outcomes from the negotiation for the acquisition of 1064 locomotives concluded in March 2014.

Background

Transnet issued two tenders for the acquisition of 1064 locomotives (465 diesel and 599 electric locomotives) as was outlined in the locomotive deployment plan to ensure that Transnet Freight Rail (TFR) would be in a position to provide the required traction capacity in support of the MDS.

The tender evaluation process was concluded in January 2014 and the results thereof were approved by the Transnet Board. The Transnet Board also approved that negotiations with the 2 preferred bidders for the 465 diesel locomotive tender i.e. General Electric South Africa Technologies (GE) and the CNR Consortium (CNR), and the 2 preferred bidders for the 599 electric locomotive tender i.e. Bombardier Transportation South Africa (Pty) Ltd (BT) and CSR E-Loco Supply (Pty) Ltd (CSR), commence.

The Transnet Board Acquisition and Disposal Council (BADC) approved an allocation of locomotives between the preferred bidders for the diesel locomotives on a 50/50 split basis i.e. 233 locomotives to GE and 232 locomotives to CNR and a 60/40 split basis for the electric locomotives i.e. 359 for CSR and 240 for BT.

Negotiations commenced in February 2014. Negotiations were completed in March 2014 and the contracts were signed on 17 March 2014.

The key outcomes from the negotiations are detailed in this report.

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Executive Summary

465 Diesel Locomotives

The final negotiated price per locomotive, excluding the cost of hedging and future inflationary escalations for GE is **R 30 265 400** and for CNR is **R 34 000 000.** The mandate relating to pricing as set out in the negotiation strategy was met.

The final negotiated price per locomotive, including the cost of hedging and fixed for future inflationary escalations for GESAT is **R 36 174 650** and for CNR is **R 42 875 020.** The mandate relating to pricing including hedging and escalations as set out in the negotiation strategy was met.

The GE price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional Transnet Engineering (TE) scope and changes to economic conditions including escalation and hedging costs of, R 39.6 million to a final hedged base price including escalations of R 36.2 million per locomotive. This resulted in a net saving of R 3.4 million per locomotive or a saving of R 790 million for all 233 locomotives.

The CNR price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional TE scope and changes to economic conditions including escalation and hedging costs, of R 49.8 million to a final hedged base price including escalations of R 42.9 million per locomotive. This resulted in a net saving of R 6.9 million per locomotive or a saving of R 1.6 billion for all 232 locomotives.

599 Electric Locomotives

The final negotiated price per locomotive, excluding the cost of hedging and future inflationary escalations for BT is **R 43 690 574** and for CSR is **R 40 854 785.** The mandate relating to pricing as set out in the negotiation strategy was met.

The final negotiated price per locomotive, including the cost of hedging and fixed for future inflationary escalations for BT is **R 54 371 693** and for CSR is **R 50 480 000.** The mandate relating to pricing including hedging and escalations as set out in the negotiation strategy was met.

The BT price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional Transnet Engineering (TE) scope and changes to economic conditions including escalation and hedging costs of, R 61.5 million to a final hedged base price including escalations of R 54.4 million per locomotive. This resulted in a net saving of R 7.1 million per locomotive or a saving of R 1.7 billion for all 240 locomotives.

The CSR price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional TE scope and changes to economic conditions including escalation and hedging costs, of R 60.6 million to a final hedged base price including escalations of R 50.5 million per locomotive. This resulted in a net saving of R 10.2 million per locomotive or a saving of R 3.6 billion for all 359 locomotives.

Estimated Total Cost (ETC)

The Transnet Board approved Estimated Total Cost (ETC) for 1064 locomotives of R 38.6 million, which excluded the costs of future inflationary escalations and foreign exchange hedging costs, was not met (refer figure 1 below), and it is recommended that approval for this is obtained from the relevant authority.

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Figure 1:

Summary of ETC calculation

	Electric		
	Bombardier	CSR	Total
	240 (40%)	359 (60%)	599
Final Locomotive cost	54 371 693	50 480 000	
Estimated Total Cost excluding Hedging, Escalation	10 485 737 760	14 666 853 455	25 152 591 215
Estimated Total Cost including Hedging & Escalation	13 049 206 320	18 122 320 000	31 171 526 320

	Diesels		
	CNR	GE	Total
	232 (50%)	233 (50%)	465
Final Locomotive cost	42 875 020	36 174 650	
Estimated Total Cost excluding Hedging and Escalation	7 888 000 000	7 051 838 200	14 939 838 200
Estimated Total Cost including Hedging and Escalation	9 947 004 640	8 428 693 450	18 375 698 090

	Diesel + Electric
	Grand Total
	1 064
Estimated Total Cost excluding Hedging and Escalation	40 092 429 415
Estimated Total Cost including Hedging and Escalation	49 547 224 410
Transnet Board Mandate (ETC) for 1064 locomotives excluding hedging and excluding escalations	38 500 000 000

Note that the ETC above excludes the cost of any options, variations capital spares, initial spares, tools and test equipment, as these will be agreed to at the Design Review stage of the contract. A further 10 % should at least be added to cover this cost.

Proposed Estimated Total Cost including Hedging, Escalation, options, spares, tools and test equipment	54 502 000 000

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Economic conditions and factors that impacted the price since close of the tender

Spot Foreign Exchange Rates

The RFP was issued in July 2012 and finally closed on the 30th of April 2013. Bidder's submissions were based on economic conditions during this period. As negotiations were only finalised on the 17th of March 2014, a period of nearly 11 months had elapsed since the close of the tender, during which economic conditions had shifted considerably.

The Rand had deteriorated from 8.98 Rand to the US Dollar in April 2013 to 10.72 Rand to the US Dollar as at March 2014. This equates to a 19.4 % decline in the Rand against the US Dollar during this period. The Rand also deteriorated from 11.86 Rand to the Euro in April 2013 to 14.87 Rand to the Euro as at March 2014, which equates to a 25.5 % deterioration against the Euro during this period.

Note that the spot rate of exchange used in the business case to calculate the base price of the locomotive was 9.13 Rand to the US Dollar, as compared to the spot exchange rate as at contract signature date of 10.72 Rand to the US Dollar. This has impacted the expected price of the locomotive as per the business case and ultimately the Estimated Total Cost (ETC) as approved by the board by approximately 17 %.

Cognisance must be taken that during the negotiations a potential risk relating to the impact on the Rand due to the potential imminent war in the Ukraine emanated, contributing towards the view to fix the Rand at current levels and finalise the negotiation and contracting process speedily.

Please refer to an article from the Business Day re-emphasising the volatility of the Rand that can be expected going forward attached hereto as Annexure A.

Inflation

The cost of labour and materials required to build the locomotives have increased locally within South Africa and globally over this period. On average local CPI has increased by 6.1 % over the period December 2012 to January 2014, during which bidders would have been obtaining pricing from their suppliers. Foreign equivalent indices have increased on average by about 1.5 % to 2.5 % over the same period. Local content related to this build is on average about 60 % therefore the higher increase on the local indices carry more weight. Economic forecasts also indicate that this upward trend will continue over the next few years.

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The ETC as listed in the business case was calculated at a point in time i.e. April 2013 and excluded the cost of escalation linked to inflation. This has impacted the expected price of the locomotive as per the business case and ultimately the Estimated Total Cost (ETC) as approved by the Transnet Board.

Bidders have also built a risk premium into their pricing for forward looking inflation, to cater for the unpredictable nature of the labour environment within South Africa and the risk associated with Transnet Engineering carrying out this additional *new* scope of work provided.

Batch Size

As approved by the Transnet Board the four preferred bidders were advised that the batch size has been split on a 50/50 basis for the 465 diesel locomotive tender and on a 60/40 basis for the 599 electric locomotive tender, amongst them. As a result, the fixed costs related to setting up the production line would have to be recouped over a smaller batch. This resulted in an increase in the cost per locomotive. Note that although the cost per locomotive would have increased, an overall saving is realised due to splitting the batch, because of the saving made on future escalations and hedging costs as a result of a shorter delivery period (refer section below explaining this in more detail).

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Overall impact of economic conditions and other factors on the price

The price of the locomotive was thus impacted as follows as a result of the change in economic conditions and other factors as explained above:

Figure 2:

	Diesels	
	CNR	GE
	232 (50%)	233 (50%)
Best and Final Offer per Board submission	**27 360 000**	**24 312 000**
Adjusted for changes to:	7 059 026	5 509 100
Escalation up to signature date (from close of tender to Mar 14) Forex adjustment to spot rate at 17 March 2014 Batch pricing adjustment for reduction of batch size to 50 %		
Best and Final Offer updated for economic and other factors	**34 419 026**	**29 820 800**

	Electrics	
	Bombardier	CSR
	240 (40%)	359 (60%)
Best and Final Offer per Board submission	**29 049 486**	**28 890 000**
Adjusted for changes to:		
Escalation up to signature date (from close of tender to Mar 14) Forex adjustment to spot rate at 17 March 2014 Batch pricing adjustment for reduction of batch size to 40 % / 60 %		
Best and Final Offer updated for economic and other factors	**42 291 574**	**39 741 013**

Initial bidder pricing submissions relating to these economic and other factors, were higher than as presented in figure 2 above. Through the negotiation process these initial submissions were reduced by R 2.5 million for CNR, R 252 700 for GE, R 1.5 million for BT and R 10 million for CSR to the levels reflected above.

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Impact of splitting the batch between the bidders

The Transnet Board Acquisition and Disposal Council (BADC) approved an allocation of locomotives between the preferred bidders for the diesel locomotives on a 50/50 split basis i.e. 233 locomotives to GE and 232 locomotives to CNR and a 60/40 split basis for the electric locomotives i.e. 359 locomotives for CSR and 240 locomotives for BT.

As a result the delivery schedule was accelerated thereby ensuring that the locomotives arrived earlier resulting in savings in future inflation related escalation costs and savings in foreign exchange hedging costs.

This also resulted in an increase in the cost per locomotive due to bidders having to allocate more of the sunk capital costs to a smaller batch.

The net saving as a result of this decision as calculated by Regiments Capital (approved transaction advisors) is reflected below in figure 3:

Additional benefits not quantified below would include the ability to deliver additional volumes earlier thereby earning additional revenue earlier.

Figure 3:

Summary of Impact of reducing Batch Size	GE Per Loco	CNR Per Loco
Escalation if a batch of 465 was ordered based on original delivery schedule	7 416 495	3 140 096
Hedging cost if a batch of 465 was ordered based on original delivery schedule	3 451 690	5 793 762
Escalation if a batch of 233/232 is ordered based on revised delivery schedule	5 140 840	2 770 643
Hedging cost if a batch of 233/232 was ordered based on revised delivery schedule	2 393 702	5 073 921
Saving on escalation	2 275 655	369 453
Saving on hedging	1 057 988	719 841
Total Saving	3 333 643	1 089 294
Additional cost as submitted by Bidder to reduce batch size	3 133 715	269 975
Net saving	199 928	819 319

Notes:
The forecasts were based on using historical trends of appropriate indices as calculated by Regiments Capital.
The calculations above are based on information available at a point in time to Regiments.
The above calculations were prepared to demonstrate the impact of reducing the batch size and will not tie up to the final negotiated position.

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Summary of Impact of reducing Batch Size	Bombardier Per Loco	CSR Per Loco
Escalation if a batch of 599 was ordered based on original delivery schedule	13 648 715	11 578 427
Hedging cost if a batch of 599 was ordered based on original delivery schedule	7 509 396	7 012 405
Escalation if a batch of 240/359 is ordered based on revised delivery schedule	6 487 680	6 248 487
Hedging cost if a batch of 240/359 was ordered based on revised delivery schedule	3 424 108	3 607 263
Saving on escalation	7 161 035	5 329 940
Saving on hedging	4 085 288	3 405 142
Total Saving	11 246 323	8 735 082
Additional cost as submitted by Bidder to reduce batch size	5 859 171	1 618 500
Net saving	5 387 152	7 116 582

Notes:
The forecasts were based on using historical trends of appropriate indices as calculated by Regiments Capital.
The calculations above are based on information available at a point in time to Regiments.
The above calculations were prepared to demonstrate the impact of reducing the batch size and will not tie up to the final negotiated position.

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Negotiation Mandate

A draft mandate from the delegated authority to negotiate appropriate or better terms for the following items was issued to the negotiation team:

1. Pricing
2. Payment terms
3. Delivery risk mitigation
4. Escalation risk mitigation
5. Foreign exchange risk mitigation
6. Advance payment risk mitigation
7. Total cost of ownership (Fuel/Energy) risk mitigation
8. Warranties
9. Deferral of the delivery schedule
10. Break Pricing
11. Impact of Transnet Engineering (TE) additional scope
12. Alignment of pricing between bidders

Outcomes from the Negotiations

The following items were negotiated at length in scheduled face-to-face meetings between Transnet representatives and those of GE, CNR, BT and CSR. There were a number of proposals and counter-proposals which lead to the formation of a common understanding and agreement between the two parties.

1. Pricing

465 Diesel Locomotives

The GE price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional Transnet Engineering (TE) scope and economic conditions including escalation and hedging costs of, R 39.6 million to a final hedged base price including escalations of R 36.2 million per locomotive. This resulted in a net saving of R 3.4 million per locomotive or a saving of R 790 million for all 231 locomotives.

The CNR price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional TE scope and economic conditions including escalation and hedging costs, of R 49.8 million to a final hedged base price including escalations of R 42.9 million per locomotive. This resulted in a net saving of R 6.9 million per locomotive or a saving of R 1.6 billion for all 232 locomotives.

599 Electric Locomotives

The BT price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional Transnet Engineering (TE) scope and changes to economic conditions including escalation and hedging costs of, R 61.5 million to a final hedged base price including escalations of R 54.4 million per locomotive. This resulted in a net saving of R 7.1 million per locomotive or a saving of R 1.7 billion for all 240 locomotives.

The CSR price per locomotive was negotiated downwards from the best and final offer price at the start of negotiations adjusted for the impact of the smaller batch size, additional TE scope and changes to economic conditions including escalation and hedging costs, of R 60.6 million to a final hedged base price including escalations of R 50.5 million per locomotive. This resulted in a net saving of R 10.2 million per locomotive or a saving of R 3.6 billion for all 359 locomotives.

Estimated Total Cost (ETC)

The Transnet Board approved Estimated Total Cost (ETC) for 1064 locomotives of R 38.6 million, which excluded the costs of future inflationary escalations and foreign exchange hedging costs, was not met (refer figure 1 above), and it is recommended that approval for this is obtained from the relevant authority.

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2. Payment Terms

The following payment terms were agreed to:

Figure 4:

Payment terms	CNR	GE
Advance Payment	10%	10%
Design review	5%	
Acceptance	75%	87%
Retention	10%	3%

Payment terms	Bombardier	CSR
Advance Payment	9%	10%
6 Months / Design review	9%	20%
After 17 months	9%	
Acceptance	68%	65%
Retention	5%	5%

There were a number of proposals and counter-proposals and the payment terms above were agreed to as part of a package deal obtained with the price reduction referred to above.

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3. Delivery Schedule and Delivery Risk Mitigation

The locomotives will be delivered at a rate of 12 locomotives per month per bidder at peak production as per the summarised delivery schedule below (refer figure 5). In order to mitigate against late delivery risk, a penalty regime capped at 10 % of the contract price has been agreed to with all bidders.

Figure 5:

Delivery Schedule - Diesel Locomotives	CNR	GE
	232 (50%)	233 (50%)
	CNR 1st 20 from China	GE 1st 6 from USA
by March 2015	0	0
by March 2016	20	34
by March 2017	87	126
by Oct 2017	84	73
by February 2018	42	
Locomotives will be manufactured at a peak tempo of 12 per month.		

Delivery Schedule - Electric locomotives	Bombardier	CSR
	240 (40%)	359 (60%)
	BT produce all loco's locally	CSR 1st 40 from China
by March 2016	6	88
by March 2017	137	142
by December 2017	97	
by January 2018		129
Locomotives will be manufactured at a peak tempo of 12 per month.		

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4. Escalation Risk Mitigation:

In order to mitigate against the risk that the cost of forward looking inflation will materially impact the price of the locomotive over the delivery period, it has been agreed with bidders that the cost of escalation linked to forward looking inflation is included in the price of the locomotive as detailed in figure 1 above. i.e. escalation risk for TFR is removed as the cost of escalation is now included in the price and the price is not subject to a change in inflation related escalation indices.

The premium paid per locomotive to fix this escalation cost into the price is reflected below:

Figure 6:

Escalations	CNR	GE
Cost to fix forward looking inflationary escalations	4 836 526	3 946 138
Escalations	**Bombardier**	**CSR**
Cost to fix forward looking inflationary escalations	7 646 119	7 936 367

Bidders built a risk premium into their pricing for forward looking inflation, to cater for the unpredictable nature of the labour environment within South Africa, however although not negotiated away entirely this was negotiated down to more reasonable market related levels.

There were a number of proposals and counter-proposals and the cost of escalation above was negotiated downwards for CNR from R 8.7 million to R 4.8 million per locomotive and for GE from R 5.1 million to R 3.9 million per locomotive resulting in a net saving per locomotive of R 3.9 million for CNR and R 1.1 million for GE.

The cost of escalation above was negotiated downwards for BT from R 9.1 million to R 7.6 million per locomotive and for CSR from R 17.6 million to R 7.9 million per locomotive resulting in a net saving per locomotive of R 1.5 million for BT and R 9.7 million for CSR.

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5. Foreign Exchange Risk Mitigation

In order to mitigate against the risk that changes to spot foreign exchange rate will materially impact the price of the locomotive over delivery period, it has been agreed with bidders that this risk would remain on their balance sheet. It was also agreed that bidders would be responsible for hedging the foreign exchange exposure. The cost of foreign exchange hedging is included in the price of the locomotive as detailed in figure 1 above. I.e. foreign exchange risk and hedging risk for TFR is removed as the cost of hedging is now included in the price and the price is not subject to a change in foreign exchange rates. Bidders are also now responsible for the costs related to the maintenance and rolling of hedges should delays in delivery be experienced.

The premium paid per locomotive to fix this foreign exchange hedging cost into the price is reflected below:

Figure 7:

Foreign Exchange Hedging Costs	CNR	GE
Cost to fix the price and mitigate against forex movements	4 038 494	1 963 112
Foreign Exchange Hedging Costs	**Bombardier**	**CSR**
Cost to fix the price and mitigate against forex movements	3 035 000	1 688 888

Due to the agreed payment terms for Milestone 1 and Milestone 2 for CNR and Milestone 1 for GE, the cost of hedging was significantly reduced as bidders were requested to allocate these payments to the foreign amounts first, however that saving was slightly offset by a concomitant increase in the APG cost as more funds would have to be paid earlier.

It needs to be noted that CNR's hedging cost is more expensive than GE's hedging cost due to CNR having a dual currency contract, a longer delivery period and more foreign content due to initial set up and design costs incurred overseas.

Also CSR's hedging cost is cheaper than that of BT, as the cost of hedging was negotiated down to this level with CSR. It is our view that the cost of hedging for CSR will in fact be a lot higher than the final negotiated number agreed to as reflected in figure 7 above. It is also our view that CSR will be keeping this position open and will not enter into an FEC

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contract to hedge for foreign exchange movements even though the agreement is that CSR carries all risk relating to foreign exchange movements and hedging.

The decision to enter into a Rand based contract and ensure that suppliers hedge via FEC contracts for the full contract amount is justified as historically the Rand has shown a continuous depreciating trend. The full hedging of forex risk exposures is also a requirement of the board approved financial risk management framework. Alternative collar structures whereby entering into an arrangement to participate in any improvement in the exchange rate was not considered mainly because the participation route was proving not to be cost effective. Other factors influencing this decision included the view that the depreciated currency supports exports and as such the government would not support a significant strengthening of the Rand. Hedging on the Transnet balance sheet would also have required significant credit lines from banks which can hamper credit line availability for other MDS projects. Furthermore hedging on the Transnet balance sheet requires onerous hedge accounting processes to be instituted, as prescribed by IAS 39, which can result in income statement volatility which is not optimal.

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6. Advance Payment Risk Mitigation

All advance payments are secured by an advance payment guarantee issued by a bank with a minimum long term credit rating of an A- Fitch rating or equivalent.

7. Total Cost of Ownership Risk (Fuel/Energy) Mitigation

In order to mitigate against the risk that the locomotives once placed into operation will consume more fuel (diesel locomotives) or energy (electric locomotives) than indicated in bidders responses to the RFP, a penalty clause with a related fuel/energy warranty regime has been included in the supply agreement with bidders.

8. Warranties

GE have agreed to provide a 30 month warranty on the locomotive as well as a 6 year warranty on the traction motor and a 12 month warranty on spares.

CNR, BT and CSR have agreed to provide a 24 month warranty on the locomotive as well as a 6 year warranty on the traction motor and a 12 month warranty on spares.

9. Deferral of the delivery schedule

In order to mitigate against the risk of having to accept and pay for locomotives during an economic downturn when volumes from customers may not be forthcoming thereby impacting negatively upon Transnet's loan covenants, bidders agreed to accept a clause in the supply agreement whereby acceptance of locomotives could be deferred for a period of time.

Transnet agreed that in return bidders would be reimbursed for reasonable and auditable costs. These costs could include warehousing costs, time value of money costs, costs related to the rolling of hedges etc.

Due to complications relating to hedge accounting within the accounting records of GE, it was agreed with GE that the mechanics of this arrangement would be agreed to post the contract signature date.

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10. Break Pricing

A liability cap of 15 % of the contract price is included in the supply agreement thereby limiting Transnet's exposure in the unlikely event of breach of contract by Transnet.

11. Impact of Transnet Engineering (TE) Additional Scope

A strategic decision was taken at a Transnet level that TE should be enabled to eventually be able to become an Original Equipment Manufacturer (OEM) of locomotives. This 1064 tender process would be used as a catalyst to facilitate this strategy. As such bidders were advised to provide pricing based on providing TE with additional scope for the manufacture of the locomotives. Strategically it was decided that for specific items within the build process where TE were within 10 % of the market price then it would be acceptable to allow TE to retain this scope. The pricing as reflected above in Figure 1 is inclusive of this additional scope for TE based on this principle.

12. Alignment of Pricing between Bidders

It should be noted that GE and CSR already have established production lines within South Africa as they have previously already entered into contracts with Transnet to build locomotives. GE and CSR have also had a head start in establishing supply chains for sub components in South Africa. As such there pricing is lower than that of their counterparts CNR and Bombardier.

Through the negotiation process, the team endeavoured to align prices between the bidders; however the expectation was never to align prices completely due to the reason as explained above.

Also it was always understood that one of the reasons the Transnet Board approved a split award of the tender was to ensure that adequate competition exists in the market, for which a slight premium would have to be paid in the beginning.

As such, based on this understanding we believe that the negotiation mandate relating to alignment of pricing between bidders has been met.

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Conclusion

It is recommended that a submission is made to the requisite authorities requesting an increase in ETC for 1064 locomotives of R 54.5 billion based on the outcomes of the negotiation process.

Based on the outcomes of the negotiation process the draft negotiation mandate as supplied has been met.

Sign-off

Yousuf Laher
Executive manager
TFR Finance

Danie Smit
Deputy Treasurer Middle Office
Transnet Group

CC:
Thamsanqa Jiyane

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Annexure A

Economy

Rocky ride forecast for 'still too expensive' rand

by Evan Pickworth, 18 March 2014, 05:53

A GAUGE by Swiss bank UBS that assesses 22 exchange rates according to their trade balances on Monday found that the rand was 10% too expensive, signalling fears the currency is in for a rough ride for the rest of the year.

After losing about a third of their value in three years, the rand and Turkey's lira still need to fall further to reach levels that make their economies competitive, according to the report. Analysts point to structural problems that monetary policy alone cannot fix as key risks in the future, with further weakness to well more than R11 to the dollar on the immediate horizon before a period of stability can kick in.

The rand weakened to its worst levels in five years in January as investment opinion turned swiftly away from emerging markets. Together with the Turkish lira and Argentinian peso, the rand was the weakest global currency in January, but a shrinkage in the current account deficit and an easing in fears over the crisis in the Ukraine, have seen volatility subside.

UBS said the Turkish lira was 12% overvalued and with the rand made up the worst levels among the currencies being monitored.

But French bank Société Générale pointed out that both currencies have risen over the past six weeks as a result of interest rate increases rather than improvements in their economies.

"The rand and lira are still expensive," Shewta Singh, an emerging-market economist at Lombard Street Research, said in an interview last week. "The currencies are not appealing relative to the risks."

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Emerging markets economist at Nomura International Peter Attard Montalto said on Monday he had found the rand to be at fair value in January, but that it was notoriously difficult to predict the future of the currency. He expected volatility to persist and said the rand might weaken to as low as R11.25 this year.

The currency was at R10.73 to the dollar late on Monday from R10.68 at the end of last week.

Mr Montalto said another interest rate increase could not be ruled out but consensus among market watchers was edging to an unchanged stance.

The Reserve Bank monetary policy committee's three-day meeting begins next week on Tuesday, with an announcement on rates to follow on Thursday.

Mr Montalto expected two rate hikes this year and two more next year, before a more neutral stance could be expected.

Investment Solutions chief economist Chris Hart said while he could see the rand becoming "quite a bit weaker", he felt the recent strikes were not providing a "true picture" of South Africa's trade balance as fewer goods were supplied while workers stayed away.

He expected the rand to weaken further as the US tapering programme began to "bite", but then to stabilise later.

The US Federal Reserve is expected to reduce its quantitative easing programme by $10bn on Wednesday, according to research by Barclays.

In addition to this week's inflation data on Wednesday, the release of the Nkandla report on upgrades to President Jacob Zuma's home and further industrial action, the rand could also be "materially influenced by the Crimean secession referendum" and the Fed's meeting, Barclays said.

Global market participants are waiting for the Fed's policy statement on Wednesday, with the bank expected to continue to pare back on its monetary stimulus programme.

The rand weakened to more than R11 to the dollar, its weakest level since 2008, in January, raising speculation at the time that it might stay weak for as long as five years.

Turkey hiked rates in January to 12% from 7.75% in response to a sell-off in the lira.

The action by the Turkish central bank coincided with a surprise decision by South Africa's Reserve Bank to increase rates 50 basis points to 5.5%.

The lira slid to fresh all-time lows against the dollar in January on concerns over its current account deficit and has hit five-week lows to the dollar.

French bank Credit Agricole estimated the rand would remain little changed at R10.60/$ by year end, and is the third-most bearish firm in Bloomberg's survey. The lira might depreciate a further 8% by the end of the year, it said.

"Turkey and South Africa lack competitiveness," Sebastien Barbe, the head of emerging-market research at France's third-biggest bank, said in a March 7 phone interview from Paris. "It's difficult to argue that these currencies have cheapened enough."

With Bloomberg

910

1064 Locomotives - Summary Calculation	599 Electrics	465 Diesels	Total 1064
Base Price	25,152,591,215	14,939,838,200	40,092,429,415
Escalation (forward looking to fix price)	4,684,224,313	2,041,524,186	6,725,748,499
Hedging (forward looking to fix price)	1,334,710,792	1,394,335,704	2,729,046,496
Total	31,171,526,320	18,375,698,090	49,547,224,410

Transnet Board Mandate (ETC) for 1064 locomotives excluding hedging and excluding escalations 38,600,000,000

911

Summary of ETC calculation

	Total	Electrics	
		Bombardier	CSR
		240 (40%)	359 (60%)
Estimated Total Cost excluding Hedging, Escalation	25,152,591,215	10,485,737,760	14,666,853,455
Estimated Total Cost including Hedging & Escalation	31,171,526,320	13,049,206,320	18,122,320,000

	Total	Diesels	
		CNR	GE
		232 (50%)	233 (50%)
Estimated Total Cost excluding Hedging and Escalation	14,939,838,200	7,888,000,000	7,051,838,200
Estimated Total Cost including Hedging and Escalation	18,375,698,090	9,947,004,640	8,428,693,450

	Diesel + Electric
	Grand Total
	1,064
Estimated Total Cost excluding Hedging and Escalation	40,092,429,415
Estimated Total Cost including Hedging and Escalation	49,547,224,410

912

Award of 599 Electric Locomotive Contract	Total	Electrics		
		Bombardier	CSR	
		240 (40%)	359 (60%)	
Best and Final Offer per Board submission		29,049,486	28,890,000	0.6%
Adjusted for changes to:				
Escalation up to signature date (from close of tender to Mar 14)				
Longer delivery schedule impact due to production rate tempo of 12 per month				
Forex adjustment to spot rate at 17 March 2014				
Batch pricing adjustment for reduction of batch size to 40 % / 60 %				
Best and Final Offer updated to 17 March 2014		42,291,574	39,741,013	6.4%
Adjustments for:				
Additional TE Scope				
Negotiated discounts				
New Price including TE scope		43,690,574	40,854,745	6.9%
Cost to fix escalation to end of contract		7,646,119	7,936,367	
Cost of Hedging		3,035,000	1,688,888	
Final Locomotive cost excluding TE scope		54,371,693	50,480,000	7.7%
Estimated Total Cost excluding Hedging, Escalation	25,152,591,215	10,485,737,760	14,666,853,455	
Estimated Total Cost including Hedging & Escalation	31,171,526,320	13,049,206,320	18,122,320,000	

Delivery Schedule	BT produce all loco's locally	CSR 1st 40 from China
by March 2016	6	88
by March 2017	137	142
by December 2017	97	
by January 2018		129

Payment terms		
Deposit	[illegible]	10%
Design review		20%
Acceptance	68%	65%
Retention	5%	5%

Delay penalties	Capped @ 10 % of total contract price	Capped @ 10 % of total contract price
SD penalties	Capped @ 2.5 % of SD value	Capped @ 2.5 % of SD value
FRC penalties	Capped @ 7.5 % of SD value	Capped @ 7.5 % of SD value

913

Award of 465 Diesel Locomotive Contract		CNR 232 (50%)	GE 233 (50%)	
Best and Final Offer per Board submission		27,360,000	24,312,000	12.5%
Adjusted for changes to:				
Escalation up to signature date (from close of tender to Mar 14)				
Longer delivery schedule impact due to production rate tempo of 12 per month				
Forex adjustment to spot rate at 17 March 2014				
Batch pricing adjustment for reduction of batch size to 50 %				
Best and Final Offer updated to 17 March 2014		34,419,026	29,820,800	15.4%
Adjustments for:				
Additional TE Scope				
Negotiated discounts				
New Price including TE scope		34,000,000	30,265,400	12.3%
Cost to fix escalation to end of contract		4,836,526	3,946,138	
Cost of Hedging		4,038,494	1,963,112	
Final Locomotive cost		42,875,020	36,174,650	18.5%
Estimated Total Cost excluding Hedging and Escalation	14,939,838,200	7,888,000,000	7,051,838,200	
Estimated Total Cost including Hedging and Escalation	18,375,698,090	9,947,004,640	8,428,693,450	

Delivery Schedule	CNR 1st 20 from China	GE 1st 6 from USA
by March 2015	0	
by March 2016	20	34
by March 2017	87	126
by Oct 2017		73
by February 2018	42	

Payment terms			
	Deposit	10%	10%
	Design review	5%	
	Acceptance	75%	87%
	Retention	10%	3%

Delay penalties	Capped @ 10 % of total contract price	Capped @ 10 % of total contract price
SD penalties	Capped @ 2.5 % of SD value	Capped @ 2.5 % of SD value
FRC penalties	Capped @ 7.5 % of SD value	Capped @ 7.5 % of SD value

914

Statistics

	Per Loco	Total Price	Delivery	Payment terms
60 Diesels to GE	29,196,647	1,751,798,820	60 by August 2015	70/27/3
100 Electrics to CSR	44,000,000	4,400,000,000	100 by Sep 2015 of which 40 would be from China	30/30/37/3

915

1064 Locomotives - Summary Calculation	599 Electrics	465 Diesels	Total 1064
Base Price	25,152,591,215	14,939,838,200	40,092,429,415
Escalation (forward looking to fix price)	4,684,224,313	2,041,524,186	6,725,748,499
Hedging (forward looking to fix price)	1,334,710,792	1,394,335,704	2,729,046,496
Total	31,171,526,320	18,375,698,090	49,547,224,410

Transnet Board Mandate (ETC) for 1064 locomotives excluding hedging and excluding escalations 38,600,000,000

916

Summary of ETC calculation

	Total	Electrics	
		Bombardier	CSR
		240 (40%)	359 (60%)
Estimated Total Cost excluding Hedging, Escalation	25,152,591,215	10,485,737,760	14,666,853,455
Estimated Total Cost including Hedging & Escalation	31,171,526,320	13,049,206,320	18,122,320,000

	Total	Diesels	
		CNR	GE
		232 (50%)	233 (50%)
Estimated Total Cost excluding Hedging and Escalation	14,939,838,200	7,888,000,000	7,051,838,200
Estimated Total Cost including Hedging and Escalation	18,375,698,090	9,947,004,640	8,428,693,450

	Diesel + Electric
	Grand Total
	1,064
Estimated Total Cost excluding Hedging and Escalation	40,092,429,415
Estimated Total Cost including Hedging and Escalation	49,547,224,410

91

Award of 599 Electric Locomotive Contract	Total	Electrics		
			Bombardier	CSR
			240 (40%)	359 (60%)
Best and Final Offer per Board submission			29,049,486	28,890,000	0.6%
Adjusted for changes to:				
Escalation up to signature date (from close of tender to Mar 14)				
Longer delivery schedule impact due to production rate tempo of 12 per month				
Forex adjustment to spot rate at 17 March 2014				
Batch pricing adjustment for reduction of batch size to 40 % / 60 %				
Best and Final Offer updated to 17 March 2014			42,291,574	39,741,013	6.4%
Adjustments for:				
Additional TE Scope				
Negotiated discounts				
New Price including TE scope			*43,690,574*	*40,854,745*	*6.9%*
Cost to fix escalation to end of contract			7,646,119	7,936,367	
Cost of Hedging			3,035,000	1,688,888	
Final Locomotive cost excluding TE scope			54,371,693	50,480,000	7.7%
Estimated Total Cost excluding Hedging, Escalation	25,152,591,215		10,485,737,760	14,666,853,455	
Estimated Total Cost including Hedging & Escalation	31,171,526,320		13,049,206,320	18,122,320,000	

Delivery Schedule	BT produce all loco's locally	CSR 1st 40 from China
by March 2016	6	88
by March 2017	137	142
by December 2017	97	
by January 2018		129

Payment terms			
	Deposit	27% (9+9+9)	10%
	Design review		20%
	Acceptance	68%	65%
	Retention	5%	5%

Delay penalties	Capped @ 10 % of total contract price	Capped @ 10 % of total contract price
SD penalties	Capped @ 2.5 % of SD value	Capped @ 2.5 % of SD value
FRC penalties	Capped @ 7.5 % of SD value	Capped @ 7.5 % of SD value

Award of 465 Diesel Locomotive Contract		CNR 232 (50%)	GE 233	
Best and Final Offer per Board submission		27,360.	24,312,000	12.5%
Adjusted for changes to:				
Escalation up to signature date (from close of tender to Mar 14)				
Longer delivery schedule impact due to production rate tempo of 12 per month				
Forex adjustment to spot rate at 17 March 2014				
Batch pricing adjustment for reduction of batch size to 50 %				
Best and Final Offer updated to 17 March 2014		34,419,026	29,820,800	15.4%
Adjustments for:				
Additional TE Scope				
Negotiated discounts				
New Price including TE scope		34,000,000	30,265,400	12.3%
Cost to fix escalation to end of contract		4,836,526	3,946,138	
Cost of Hedging		4,038,494	1,963,112	
Final Locomotive cost		42,875,020	36,174,650	18.5%
Estimated Total Cost excluding Hedging and Escalation	14,939,638,200	7,888,000,000	7,051,838,200	
Estimated Total Cost including Hedging and Escalation	18,375,698,090	9,947,004,640	8,428,693,450	

Delivery Schedule	CNR 1st 20 from China	GE 1st 6 from USA
by March 2015	0	0
by March 2016	20	34
by March 2017	87	126
by Oct 2017	84	73
by February 2018	42	

Payment terms			
	Deposit	10%	10%
	Design review	5%	
	Acceptance	75%	87%
	Retention	10%	3%

Delay penalties	Capped @ 10 % of total contract price	Capped @ 10 % of total contract price
SD penalties	Capped @ 2.5 % of SD value	Capped @ 2.5 % of SD value
FRC penalties	Capped @ 7.5 % of SD value	Capped @ 7.5 % of SD value

Statistics

	Per Loco	Total Price	Delivery	Payment terms
60 Diesels to GE	29,196,647	1,751,798,820	60 by August 2015	70/27/3
100 Electrics to CSR	44,000,000	4,400,000,000	100 by Sep 2015 of which 40 would be from China	30/30/37/3

Appendix 47 920

From: Anoj Singh Corporate JHB
Sent: 04 March 2014 12:07
To: Francis Callard Transnet Freight Rail JHB
Subject: FW: 1064 delivery scenarios

Importance: High
Sensitivity: Confidential

From: Francis Callard Transnet Freight Rail JHB
Sent: 18 February 2014 11:04 AM
To: Anoj Singh Corporate JHB
Cc: Pragasen Pillay Transnet Freight Rail JHB
Subject: RE: 1064 delivery scenarios
Importance: High
Sensitivity: Confidential

Hi Anoj

This is a challenge. Re our paper on the accelerated delivery. The best we can do is 300 locos per annum averaging 25 per month. We cannot get to peaks of 40, 50 or 60 per month. The constraints are technical commissioning staff, yards and lines to perform the acceptance tests and customer volume ramp up limitations.

Tried to call but it went into voice mail.
Please advise.
Best

Francis

From: Anoj Singh Corporate JHB
Sent: 18 February 2014 07:51 AM
To: Francis Callard Transnet Freight Rail JHB
Subject: FW: 1064 delivery scenarios

Hi F

Can you please arrange for a calculation to be performed on the above scenarios iro MDS revenues and EBITDA compared to the 2014/15 CP

Needed asap please

Thx

A

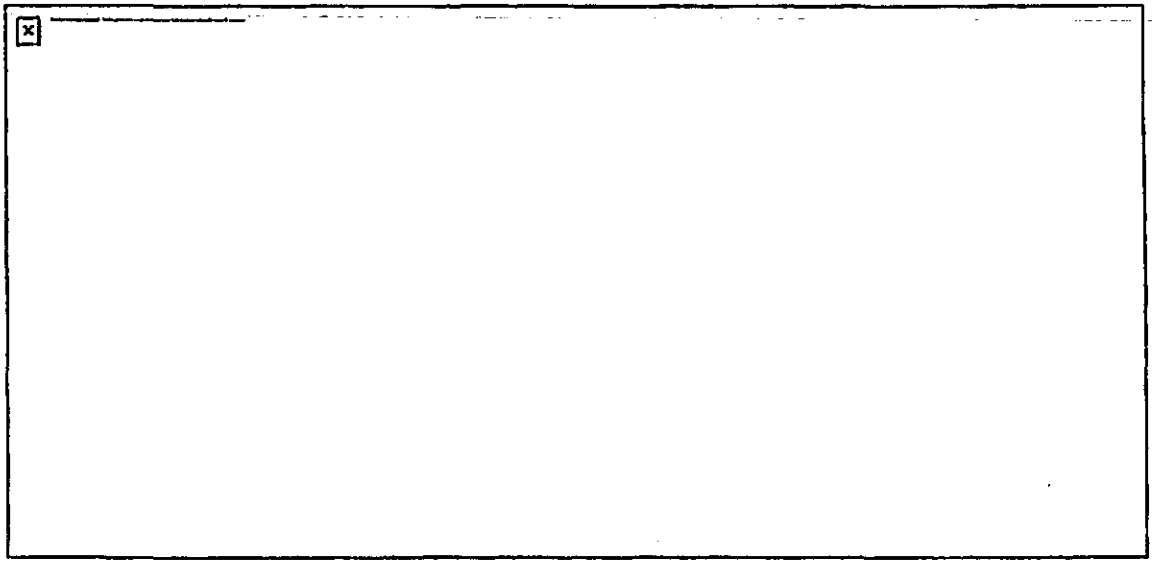
From: Garry Pita Transnet Corporate JHB
Sent: 18 February 2014 06:57 AM
To: Anoj Singh Corporate JHB
Subject: Fwd: 1064 delivery scenarios

FYI

Sent from my iPhone

Begin forwarded message:

From: "Sanjiv Sewpaul Transnet Engineering KDS" <Sanjiv.Sewpaul@transnet.net>
Date: 18 February 2014 at 3:15:30 AM SAST
To: "Garry Pita Transnet Corporate JHB" <Garry.Pita@transnet.net>, "Yousuf Laher Transnet Freight Rail JHB" <Yousuf.Laher@transnet.net>
Subject: RE: 1064 delivery scenarios



From: Sanjiv Sewpaul Transnet Engineering KDS
Sent: 17 February 2014 11:42 PM
To: Garry Pita Transnet Corporate JHB
Subject: FW: 1064 delivery scenarios

From: Sanjiv Sewpaul Transnet Engineering KDS
Sent: 17 February 2014 06:21 PM
To: Yousuf Laher Transnet Freight Rail JHB
Cc: Magan Govender Transnet Engineering KDS; Frederik Potgieter Transnet Engineering KPK; Sugen Govender Transnet Engineering KPK; Boney Susan Transnet Engineering KDS
Subject: 1064 delivery scenarios

Hi Yousuf,

Please see the delivery scenarios as requested:
Red: Import full loco delivery from OEM in SA

Green: Delivery from TE to TFR

Please note that I have left the ramp up rate (inclusive of the "import locos") as per commitment from the OEM. The 15 loco per month rate is as per OEM submission. The 10 loco per rate is TE calculation. The calcs also cater for Dec and Jan decreased values.

1064
Milestones

		Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16
Max. 60 Loco Rate	Diesel 1														
	Electric 1														
	Electric 2														
	Diesel 2														
				2	3	5	15	17	28	34	26	40	48	38	42
Max. 50 Loco Rate	Diesel 1														
	Electric 1														
	Electric 2														
	Diesel 2														
				2	3	5	15	17	25	34	26	40	44	29	34
Max. 40 Loco Rate	Diesel 1														
	Electric 1														
	Electric 2														
	Diesel 2														
				2	3	5	15	17	25	31	34	38	40	23	30

Regards,

Sanjiv Sewpaul

therefore, cannot be held liable for any loss or damages incurred by the recipient, as a result of any of the above-mentioned factors.

From: Anoj Singh Corporate JHB
Sent: 04 March 2014 12:07
To: Francis Callard, Transnet Freight Rail JHB
Subject: FW: 1064 Aggressive Schedule
Attachments: 1064_Revenue.pdf; 1064_Revenue.xlsx

From: Francis Callard Transnet Freight Rail JHB
Sent: 26 February 2014 11:12 AM
To: Anoj Singh Corporate JHB; Mohammed Mahomedy Transnet Corporate JHB
Subject: 1064 Aggressive Schedule

Hi Anoj /Mohammed

ologies for the delay. My laptop joined the ranks of the unemployed and this new one is still bedding down. Only ally online last night. I am not sure if you got the earlier mail. It was in the outbox but disappeared and is not in sent items.

The files attached refer. Also a PDF for tablet reading.
The calcs are high level and relate to the differences in revenue only. The rand per NTK is from the 1064 business case. The locomotive productivity closely matches that of the 100 plus 60. Extracting the detail from the 1064model is more time consuming.

Three scenarios.

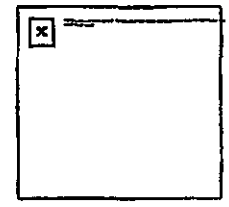
- 48 pm versus to Original
- 48 pm versus 300 per year
- 300 per year versus original

Also factored in delivery to production.

Please note (NB) that we cannot absorb more than the 300 per year due to market and commissioning constraints per e earlier note.

Best and regards

Francis



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Year	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	Total
Electric	0	33	89	86	86	86	86	86	47	0	599
Diesel	0	26	94	94	94	94	63	0	0	0	465
Original	0	59	183	180	180	180	149	86	47	0	1064
Accelerated		216	300	300	248						1064

48 month

Diesel 1	42	131	60	0							233
Electric 1	80	131	88	0							299
Electric 2	46	128	125	0							299
Diesel 2	10	71	136	16							233
Total	178	461	409	16							1064

Income per loco

Delta	48 pm to Original		178	402	226							
	Effective		10%	50%	50%	90%						
	Earning per year		18	361	314	113	0					
	MTons per loco	0,08	1,42	28,90	25,12	9,04	-	-	-	-	-	-
Per Bus Ca:	Rand per Ton Km		0,421	0,451	0,481	0,498	0,541	0,583	0,626			
	Distance		552	551	553	533	539	542	542	542	542	542
	Rand per Ton		233	248	266	265	291	316	339	0	0	0
	Income Rm		331,24	7 178,07	6 687,36	2 398,00	-	-	-	-	-	-

16 594,66

Delta	48 pm to Accelerated		178	245	109								
	Effective		10%	50%	50%	90%							
	Earning per year		18	283	177	55	0						
	MTons per loco	0,08	1,42	22,62	14,16	4,36	-	-	-	-	-	-	
Per Bus Ca:	Rand per Ton Km		0,421	0,451	0,481	0,498	0,541	0,583	0,626				
	Distance		552	551	553	533	539	542	542	542	542	542	
	Rand per Ton		233	248	266	265	291	316	339	0	0	0	
	Income Rm		331,24	5 618,05	3 769,63	1 156,56	-	-	-	-	-	-	10 875,47

Delta	300 py to 48pm		0	157	117	120	68						
	Effective		10%	50%	50%	50%	40%						
	Earning per year		0	79	137	119	87,2	40,8					
	MTons per loco	0,08	-	6,28	10,96	9,48	6,98	3,26	-	-	-	-	
Per Bus Ca:	Rand per Ton Km		0,421	0,451	0,481	0,498	0,541	0,583	0,626				
	Distance		552	551	553	533	539	542	542	542	542	542	
	Rand per Ton		233	248	266	265	291	316	339	0	0	0	
	Income Rm		-	1 560,02	2 917,73	2 514,71	2 031,33	1 030,81	-	-	-	-	10 054,60

Appendix 48 928

TFR PRELIMINARY VIEW ON EXPEDITING 1064 LOCOMOTIVES

UPDATED FOR AGGRESSIVE DELIVERY OF 480 PEAK PER YEAR

Index

Compiled by:
Francis Callard
Pragasen Pillay
& Team

Updated 11 March 2014

1 Introduction

This document was prepared in response to a request by the GCFO. The GCFO informed that the proposed delivery schedule of the 1064 locomotives is not affordable and the approximate opportunity cost of R10BN exists should the aggressive delivery schedule be shortened. The impact of this request requires an analysis of:

1. TFR's ability to commission and absorb the locomotives according to the more aggressive delivery schedule (480 per annum)
2. The market demand to take up the capacity generated
3. The review of the network constraints and the infrastructure programmes required to take up the increased capacity

Table 1

Year	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	Total
Electric	0	33	89	86	86	86	86	86	47	0	593
Diesel	0	26	94	94	94	94	63	0	0	0	461
Original	0	59	183	180	180	180	149	86	47	0	1064
Accelerated TFR Proposal		213	300	300	248						1064
Accelerated R10BN Proposal		213	480	368							1064

2 Strategy

a. To accommodate the maximum number of locomotives that TFR can absorb into operations based on the maximum tonnages that can be hauled.
b. Fast-track the parking of old locomotives and addressing operational system reliability and efficiency. Exiting of the old locomotives will be accelerated.
c. To identify the critical network constraints and the project management to meet the timelines required of the aggressive delivery schedule of the locomotives to deliver on the line tonnage ramp-up.
d. To review and adjust the maintenance of the existing locomotive fleet.
e. To have the OEM manage and be accountable for the maintenance of the 1064 locomotives during the warranty and defect liability period and provide support in the post warranty period.
f. To overcome Eskom power constraints, TFR will endeavour to operate an electric-diesel DP configuration where applicable.

Caveat: Organisational recognition of the technical nature of the work and the skills required.

3 Market

Market supports the accelerated additional tonnages.

Table 2 Aggressive GFB traffic demand against original demand

FY	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023	2023/2024
Business Plan 2014/15	97.8	110.9	130.1	144.7	159.9	169.2	173.2	177.4	183.2*	188.4*
ACCELERATED at 300	97.8	118.8	142.1	157.1	170.7					
++	-	7.9	12.0	12.4	10.8	15.1	16.4	14.5	14.3	14.0
ACCELERATED at 480	97.8	118.8	152.3	163.6	175.9					

Note * refers to MDS tonnages per the business plan submitted for 2014/15 and not resourced by the 1064 locomotives.

For detail refer to the annexure.

4 Wagons

There are implications to the wagon budget. Preliminary indications are that even for the 300 locomotive per year ramp up, ~4500 wagons are required for 2015/16. This would cost ~ R4.3bn against the budget of ~ R3bn.

TE has a peak capacity of 3200 wagons per annum. The wagon peak is temporary and this capacity should not be expanded as the demand is not sustainable beyond one or two years.

The move to 480 locomotives per year will further increase pressure on the wagon fleet for 2015/16 and production in 2014/15 (producing the year in advance to meet demand)

The vacuum to air-brake conversion will be fast-tracked.

5 Linkage to Major Projects

5.1 General

The following lists the infrastructure projects that need to be fast-tracked to support the aggressive tonnages based on the aggressive delivery of the 1064 locomotives. Not all of these projects are currently fully funded.

5.2 Majuba

Table 3 Schedule of Deliverables

Requirements		Completion timeline

5.2.1 The Majuba link line construction and tippler construction must be finalised to accommodate 14mt coal per annum.	Ali Motala	March 2016

5.3 Pyramid / Rustenburg Flows

Table 4 Schedule of Deliverables

Requirements (Capital requirements to be brought forward)		Who	Completion timeline
5.3.1	Require 200 wagon passing loops between Waterberg and Ermelo inclusive of passing loops at Pyramid South for re-man purposes (6.3mt coal + chrome expansion)	Ali Motala	March 2016
5.3.2	Thabazimbi to Lephelale to be electrified	Ali Motala	March 2016
5.3.3	AC/DC switching at Pyramid South	Ali Motala	March 2015
5.3.4	The customer sidings at the chrome sites need to be extended to accommodate 100 wagon train lengths	Ali Motala	March 2015
5.3.5	The customers to be aligned at Waterberg	Transnet – Divyesh Kalan	Oct 2014
5.3.6	Two consolidation loops at Thabazimbi (2 x 100 to 1 x 200 wagon trains), or alternatively 5.3.7.	Ali Motala	March 2016
5.3.7	Resgen to construct 200 wagon holding yard at Lephelale and TFR to guarantee cost of construction	Ali Motala	March 2016
5.3.8	Two consolidation loops at Rustenburg (2 x 100 to 1 x 200 wagon trains) for chrome (unbudgeted).	Ali Motala	March 2016
5.3.9	This supports the growth of the Waterberg and TFR's expansion	N/A	N/A

5.4 Manganese/Saldanha

Not a risk in terms of the short-term aggressive positioning, however opportunity is available should there be fast tracking of the projects such as port capacity at Ngqura.

Table 5 Schedule of Deliverables

Requirements (Capital requirements to be brought forward)		Who	Completion timeline
5.4.1	PE bulk terminal limited to 4.9mt until decommissioned	N/A	Until Ngqura is commissioned
5.4.2	PE MPT (Rail solution combination of Swartkops terminal and ALOES siding)	N/A	Until Ngqura is commissioned
5.4.3	Bloemcon containerised solution to PE	Deirdre Strydom	Ongoing
5.4.4	Ngqura expansion to 16mt (awaiting DPE approval); schedule as presented is aggressive and requires on time approval of all procurement events. Procurement delays are single biggest risk to the schedule. TFR requires that this project be brought forward due to the tonnages being aligned to MDS. Locomotives are available but export tons are constrained by the terminal project.	Deirdre Strydom	Feb 2019

5.5 Maputo

The Witbank coal, rock phosphate, and magnetite increased volumes requires infrastructure investment in the following areas:

- Phalaborwa (increased customer capability)
- Kaapmuiden-Komatipoort (increase slot capacity)
- Komatipoort-Maputo (urgent liaison with CFM, upgrade line)

Requirements		Who	Completion timeline
5.5.1	Increase the slot capacity from Komatipoort to Kaapmuiden. Increase (i) loop lengths and then (ii) number of loops.	Caesar Mtetwa	March 2015
5.5.2	Increase and upgrade the line capacity from Kaapmuiden to Maputo – CFM line. Increase to take 50 wagon trains and 20 tons per axle. Critical for magnetite.	Cleo Shiceka	March 2015
5.5.3	Query and potentially upgrade the tippler capacity at Matola.	Cleo Shiceka	

5.6 Komatipoort / Richards Bay

Capacity constrained and requires several infrastructure interventions

Requirements	Who	Completion timeline
5.6.1 Richards Bay port capacity to increase to 60 magnetite trains per week from current 35.	Caesar Mtetwa	March 2015
5.6.2 Require additional passing loops to create more slots	Caesar Mtetwa	March 2015
5.6.3 Increase loop lengths in Swaziland to Richards Bay to accommodate long trains.	Cleo Shiceka and/ or Caesar Mtetwa	March 2015

5.7 Mahikeng / Vryburg / Warrenton (Botswana Coal)

Requirements	Who	Completion timeline
5.7.1 Line to be restored to acceptable standard to haul the coal from Botswana to East London. To move from 40 to 50 wagon trains at 20 tons axle mass.	Caesar Mtetwa	Dec 2014

5.8 Risks

- Volatile demand from Eskom.
- The price of coal may rise or fall affecting the demand from Botswana.
- Capacity within the infrastructure department and TCP to execute the projects listed above.
- Critical to address, as part of the total logistics chain, the customers' ability to deal with the increased freight. This includes 1000km of private sidings and associated infrastructure material supply and transport. It must be noted that road cannot transport the rail lengths used.
- Material availability on the Infra side.
- Supply of rail contract.
- Reputational risk if commitments made to customers on aggressive schedule are not kept.

5.9 Implications

- There must be an adjustment in the capital cash flows to fast track the above to meet the aggressive tonnages as per the time lines stipulated.
- There can be no delay in approving commencing FEL studies not in Project Approvals.
- Supply Chain Services to be fully briefed and accountable for zero delay in material procurement.

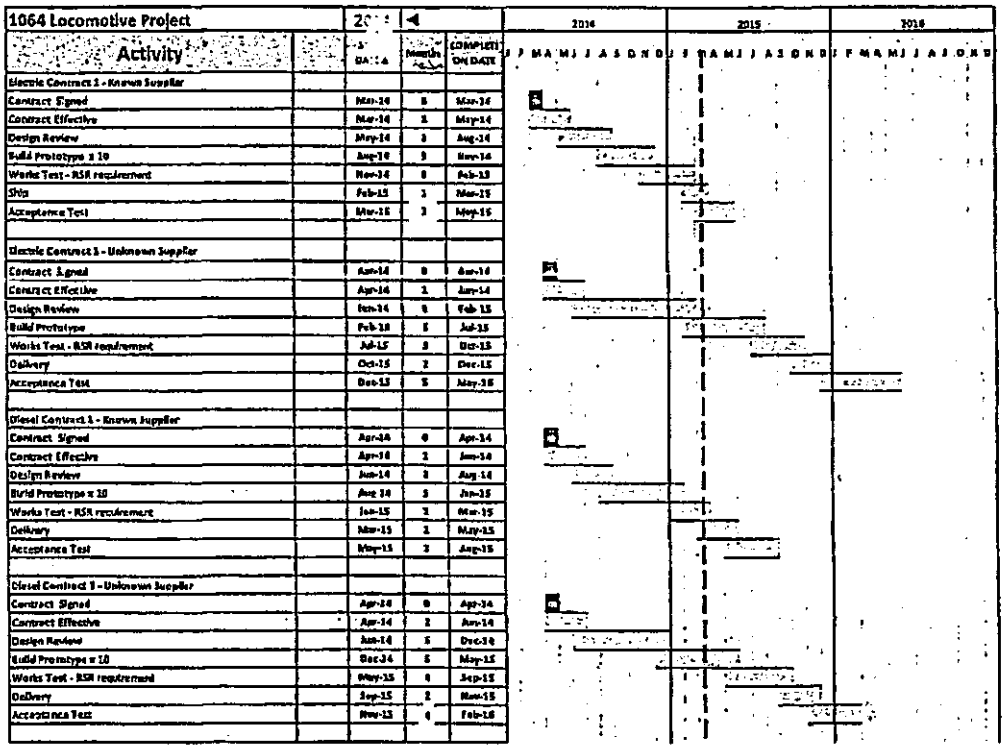
6 Delivery

6.1 General

- A locomotive is deemed delivered if and only if it is in operation.
- Ability to absorb is subject to :
  - On-time commencement of the delivery of locomotives
  - Even and consistent delivery of locomotives
- Ability to meet the tonnages is dependent on delivery and operational at the start of the financial year

6.2 From Contract signature

First 10 locomotives from each supplier to be assembled and type tested at suppliers' facility.



The dotted line reflects TE's delivery promise for the start of the aggressive ramp-up.

6.3 TE Setup and Manufacture

It is TFR's opinion that TE's ability to setup the lines on time represents a major risk.

- The teams the set up these production lines to be visible and named as setting up for local manufacture is a project in its own right.
- TE's perceived emphasis on manufacturing and becoming an OEM in its own right cannot be at the expense of maintaining the existing fleet (i.e. robbing Peter to pay Paul)
- Assume 4 production lines with two known suppliers and current production lines and two unknown suppliers with new production lines.

- OEM's will not share production lines or the same facilities to protect their intellectual property and it is unreasonable to expect them to do so.
- Based on the process of acceptance a known supplier must deliver earlier and at a faster rate than an unknown supplier.
- TFR's concern is that the start-up of local manufacture of previous contracts has not been visibly managed as a project under a dedicated and accountable programme manager according to a visible and communicated project plan. This is the cause of the delays experienced.
- Identify the program manager and make the start-up plan visible.

High Level Project Phases Include:

• Supplier Agreements
• Identify premises • Identify (assembly bays, manufacturing facility, warehouse, paint shop, offices, testing facilities) • Incoming Logistics (SCS to procure locally sourced material) (Risk – Tendering process and delays) • Vacate Premises • Prepare Premises (Paint and Clean and Power) • Equip Premises (jigs, fixtures, cranes, special tools, etc.)
• Workflow Processes • QC/QA System
• Identify People • Train People
• Receive Material (Overseas and Local) (Link to Supplier Agreements)
• Commence manufacture

7 Commissioning

7.1 General

7.1.1 Commissioning regime to be changed to cater for rapid ramp-up.

7.1.2 TFR is considering that the diesel locomotives be commissioned by TE and this matter shall be addressed at a later time.

7.1.3 There is one electrical team for "type testing (acceptance)" and one diesel team for "type testing (acceptance)". This is an inherent limitation based on available expertise.

7.1.4 TFR is looking at where additional specialised expertise may be available but it is a highly specialised and scarce resource.

7.1.5 For both electrical and diesel locomotives the "type testing (acceptance)" period cannot overlap between the two suppliers. (Refer to strategy of separating "known" and "unknown" supplier).

7.1.6 Design reviews of the electric locomotives cannot overlap; similarly the design reviews of the diesel locomotives cannot overlap; in addition both streams of locomotives cannot overlap.

7.2 Delivery and Commissioning Points

7.2.1 First 10 of any new designed locomotive type to be type tested at the supplier's overseas factory where equipment, facilities and a test beds are available. This type test includes component -, combination - and overall system type testing. The acceptance testing referred to in 7.1 is done locally for a minimum period of 91 business days and requires TFR attendance to fulfil RSR requirements.

7.2.2 The first 30 of each set of locomotives should, in TFR's opinion, be assembled at the supplier's premises while TE sets up its production facilities.

7.2.3 Commissioning (excluding the first 10 of each type) will take 1.5 weeks per locomotive.

7.2.4 For the acceptance testing 50 special test drivers will be required within TFR Technology Management (Train Design); however it is subject to review.

7.2.5 Whilst TFR has to recruit 50 specialised drivers, TFR will contract 2 retired drivers namely, Georg Noah and Apie Coetzee as a short term measure.

The following commissioning sites have been identified:

7.2.6 Durban / Empangeni (1 Electric stream; 1 diesel stream)

7.2.7 Pyramid South (1 Electric stream; 1 diesel stream)

7.2.8 Pyramid South is constrained to a maximum of 16 locomotives at any one time. Commissioning is dependent on regular and consistent delivery of locomotives

7.2.9 The testing will be done with four test coaches. Two test coaches will be used for the electric locomotive testing by TFR personnel and the other two test coaches plus a test coach specialist will be made available to TE to conduct tests on diesel. Tests cannot overlap for both types.

7.2.10 The two test coaches operating in tandem as one team shorten the test period. This will be reviewed depending on what additional expertise can be sourced

7.3 Staff

For all staffing relating to commissioning - **Rita Roper and Tumelo Mokwena**

Recruit and train test drivers per above;

The following preliminary staff arrangements are a pre-requisite:

Name	Role	Action
Required from TE – Design Reviews		
Gerhardus Gildenhuys	Senior Fleet Manager – Engine and Maintenance Specialist	Full Access
Sarel Oberholzer	Manager R&D – Product Development. – Engine and Maintenance Specialist	Full Access
Andy Mabaso	Manager – Diesel Control System Specialist	Full access for acceptance testing.
Bertus Els	Manager – Diesel Control System Specialist	Full access for acceptance testing.

8 Operations

8.1 Locomotive Preparation

8.1.1 TFR is rolling out a full preparation process that will accommodate the delivery of the 1064 locomotives

8.2 Crew

8.2.1 TFR is reviewing the crew requirements based on the aggressive tonnages and the crew will be trained ahead of demand.

8.2.2 An aggressive intake will commence in the financial year 2014/15. This ramp-up will exceed the current train crew budget.

8.2.3 Cabs are similar across all new locomotives facilitating driver training and training across series.

9 Maintenance

9.1 Maintenance

9.1.1 Not negotiable: OEM's to contract and

(i) Perform maintenance during the warranty and defect liability period including support relating to systems and sub-systems. This is required due to the rapid change in the locomotive technologies and to support TFR in-service. It is reiterated that is

essential in the warranty and defect liability period and highly desirable post the warranty period.

(ii) Train TE in maintenance procedures.

(iii) Post warranty OEM's to have a presence to transfer technology.

(iv) OEM's to provide support to TFR in-service personnel.

9.1.2 Major maintenance interventions

Adjustment based on delivery of locomotives

Table 6 Possible locomotive CAPEX/COPEX savings from 2015/16 to 2023/24

	2014/15	2015/2016	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Total
Submission 1	34,65	139,69	403,02	669,11	709,26	837,86	98,53	173,80	184,22	195,28	3 440,42
Submission 2	159,72	235,79	460,11	709,30	751,86	878,01	146,39	224,53	238,00	252,28	4 056,00
Variance	125,07	96,09	57,10	40,19	42,60	45,15	47,86	50,74	53,78	57,01	615,58

A consequence of the second aggressive delivery (Submission2) is a R4bn saving. This will be reviewed once the delivery schedule is confirmed which will inform the timing of the discontinued maintenance programmes.

Stopping the maintenance interventions at short notice has the following implications:

(i) TE staff and workshops will either idle or source alternative incoming generating activity.

(ii) An estimated R500m in working spares will no longer be required. TE to take up with Group on appropriate disposal.

9.2 Locomotive Control

Locomotive Control (also known as Technical Operating) is responsible for managing the locomotive fleet. Primary KPA's are:

(i) Ensuring locomotive availability (correct locomotive at correct place on time

(ii) That fleet is maintained

(iii) Locomotive utilisation (GTK and NTK per locomotive)

(iv) Minimising running of light locomotives

(v) Manage warranty of the locomotives

Activities of locomotive control include

(i) Proactive planning of locomotive allocation to trains up to 7 days in advance

(ii) Manage technical call outs relating to locomotive failure before departure and during trip. Accountable for decision to replace locomotive or proceed with trip Ensuring that locomotives are maintained on schedule and optimising trips to depots to avoid running light to workshops.

(iii) All new locomotives are equipped with on line condition monitoring and reporting. Technical staff in locomotive control receive the locomotive alarm condition and guide driver as to the best action (i)stop (ii) proceed with care (iii) how to rectify fault

(iv) Collate all faults relating to the locomotives, analyse and manage the warranty of the locomotives

Tools of Locomotive Control will include, amongst others, the New Integrated Train Plan software.

9.2.1 **Locomotive control (Fanie Marx and Team – currently with TE) to move to the office of Logistics Integration**

9.2.2 Locomotive control to be strengthened with a focus (measured) on proactive national planning of general freight revenue earning locomotives

9.2.3 Continuous technical monitoring of locomotive condition (real time alarms) within locomotive control (finalised technical office)

9.2.4 Key performance indicators to be developed and enforced (maintaining asset to condition and ensuring return on investment of the asset)

10 Upgrade and Maintenance Intervention Impact

The 10E/2 and 10E1 upgrade is abandoned due to aggressive introduction of the 1064 locomotives

11 Risk management – Business Case Extract

11.1 Risk overview

EXHIBIT 1

Risk assessment and rating

I High medium likelihood, high impact
II Medium likelihood, medium impact
III High medium likelihood, medium impact/ Medium likelihood, high impact
IV Low likelihood, low impact

Risk	Risk ranking	Mitigation action
Planning	II	• Specialized procurement and planning team • Conservative payment regimes to incentivize delivery • Optimize number of OEMs for planning required and benefit realized
Market	II	• Staged procurement strategy to maintain flexibility in delivery schedule and continuous monitoring of performance against MDS estimates • Execute against Market Development Strategy • Clean sheet costing to unpack key locomotive cost components
Exchange rate	II	• Hedge all foreseeable foreign currency-based expenditure as per Transnet policy
Operational readiness – Skill	II	• Develop people infrastructure plan • Upgrade training modules in line with new locomotives • Include maintenance staff training in supplier contract
Operational readiness – Capacity	II	• Implementation of 7 year maintenance plan • Increase capacity by increasing production lines and shifts • Regular review of build programme that aligns TRE factories
Operational readiness – Infrastructure	III	• Develop infrastructure expansion business plan • Implement infrastructure maintenance plan
Operational readiness – IATS[1]	II	• The IATS[1] technologies as part of the new locomotives specifications • School of Rail to provide appropriate IATS training
Transaction governance	II	• Minimize size of working team and minimize dissemination information where possible while enforcing strictest confidentiality • Enforce protocol on document sharing and data rooms
Legal	II	• Ensure transparent procurement process with accountability • Contract with multiple OEMs
Exogenous	II	• Explore long term supplier agreements with Eskom while also taking advantage of electric locomotive regenerative powers

1 Information and Administrative Technology Services

11.2 Planning and delivery risk

- approval delays - Past processes
- procurement process delays, - Past processes
- production delays - Addressed above

11.2.1 Delivery schedule sensitivities

To mitigate the risk of delays, TFR will pursue a number of strategies simultaneously, including contracting

- multiple suppliers; - 4 suppliers
- staging procurement by using international suppliers for initial batches as local supplier development ramps up; - Initial 10 from international supplier
- pursuing a conservative payment strategy[1] to incentivise delivery - Not addressed
- mitigation strategies to address the immediate locomotive shortfalls, including leveraging existing contracts, - Done – 60 Class 44
- front-loading orders with international suppliers, - Initial 10 from international supplier
- exploring leasing, and - Aurizon Locomotives
- revising the fleet run-out strategy. - Constant review

11.3 Market risk

- Market growth will not materialise.
- Inflated purchase prices (not related to forex changes) and
- Cost increases exceeding forecasts.

11.3.1 Volume

- 1 percent lower than the MDS base case of 7 percent, results in an NPV of –R1.5 billion.
- Accelerated tariff growth 1 percent above MDS results in a positive NPV of R7.8 billion.
- Tariffs have a marginal impact on CIC with the biggest impact in 2015/16, dropping from 4.0X to 3.9X.

[1] Bulk of payment made on delivery and acceptance.

EXHIBIT 2

Demand, tariffs, a[illegible] delivery schedule risk must be managed (1/2)

Greatest impact on NPV

	Sensitivities			Impact		
	Base case	Sensitivity 1	Sensitivity 2	Base case	Sensitivity 1	Sensitivity 2
1 Delivery schedule	• Delivery as per RFP: first 100 diesels in 2013-2014; first 65 electrics in 2014/15	6 months to complete procurement process 12-month diesel production 21-month electric production ~120 diesels per year ~125 electrics per year	• 8 months to complete procurement process • 18-month diesel production • 28-month electric production • ~120 diesels per year • ~125 electrics per year	• Volume impact: -49mt • Revenue impact: -R13.3bn • NPV: R2.7bn • CIC: 3.3x to 3.1x (2013/14)	• Volume impact: -110mt • Revenue impact: -R30.2bn • NPV: R2.2bn • CIC: 3.6x to 3.0x (2014/15)	• Volume impact: -155mt • Revenue impact: -R43.1bn • NPV: R1.5bn • CIC: 3.6x to 3.0x (2014/15)
2 Volume	• MDS volumes achieved	Current performance vs. MDS (~7% below)	• Volumes grow with projected GDP	• NPV: R2.7bn	• Volume impact: -59mt • Revenue impact: -R16.4bn • NPV: R1.0bn • CIC: 3.3x to 3.1x (2013/14)	• Volume impact: -259mt • Revenue impact: -R67.9bn • NPV: -R20bn • CIC: 4.1x to 2.7x (2016/17)
3 Tariffs	• ~7% annual escalation to 2019 and CPI thereafter	Escalation with CPI (~6%)	• Escalation at more than MDS (8%) to 2019; CPI thereafter	• NPV: R2.7bn	• Revenue impact: -R5.4bn • NPV: -R1.5bn • CIC: 4.0x to 3.9x (2015/16)	• Revenue impact: +R9.7bn • NPV: R7.8bn

11.4 Purchase price

- Price estimates incorrect
- Price escalations higher than current assumptions.

- capable procurement team

11.5 Costs

11.5.1 Forex risk

Forex movement sensitivities in Exhibit 38 indicate a moderate impact on NPV with a 10 percent devaluation in Rand versus USD resulting in a -R2.4 billion movement in NPV. To mitigate the risk of exchange rate fluctuations, the project will be hedged according to the Group policy.

EXHIBIT 3

Demand, tariffs, and delivery schedule risks must be managed (2/2)

	Sensitivities			Impact		
	Base case	Sensitivity 1	Sensitivity 2	Base case	Sensitivity 1	Sensitivity 2
4	• TFR Fleet Plan	• TFR fleet plan with 5% additional efficiencies	• TFR Fleet Plan with 10% additional efficiencies	• NPV: R2.7bn	• NPV: R5.2bn	• NPV: R7.6bn
5	• Hedging at current forward rate	• 10% devaluation of ZAR vs. USD	• 10% appreciation of ZAR vs. USD	• NPV: R2.7bn	• NPV: R0.3bn	• NPV: R5.2bn
6	• USD2.6m (diesel), USD3.5m (electric) before escalation	• Price increase by 10% over base case	• Price decrease by 10% from base case	• NPV: R2.7bn	• NPV: R1.2bn	• NPV: R4.3bn
7	• Costs classified as locomotives, wagons and infrastructure with an allocation of GFB overheads	• 5% increase on base costs	• 5% decrease in base costs	• NPV: R2.7bn	• NPV: -R0.8bn	• NPV: R6.3bn

11.6 Transaction governance risk

11.6.1 Each OEM to have 30 locomotives brought in to enable TFR to ramp up to required production.

11.7 Operational readiness risk

11.8 Exogenous risks

11.8.1 Energy security

- Delays (Khusile etc.)
- Energy costs
- Timely decisions
- Electrification infrastructure not installed

11.8.2 Potential strike action

ANNEXURE A

Table 7 Extract of the traffic demand schedule from 2014/15 until 2018/19 updated for the aggressive delivery schedule.

GFB AGGRESSIVE LOCOMOTIVE DELIVERY SCHEDULE TONNAGE IMPACT FLOWS										
GF GROUPFLOWS	CAPACITY NEW DEMAND 2014/2015	CAPACITY NEW DEMAND 2015/2016	CAPACITY NEW DEMAND 2016/2017	CAPACITY NEW DEMAND 2017/2018	CAPACIT NEW DEMAND 2018/201	CAPACITY NEW DEMAND 2019/2020	CAPACITY NEW DEMAND 2020/2021	CAPACITY NEW DEMAND 2021/2022	CAPACITY NEW DEMAND 2022/2023	CAPACITY NEW DEMAND 2023/2024
CHROME (EXPORT MAPUTO)	0,015	-	0,490	0,490	0,50	0,500	0,510	0,510	0,520	0,520
CHROME (EXPORT RICHARDSBAY)	4,865	5,490	5,865	5,925	6,12	6,180	6,395	6,445	6,550	6,590
COAL (EXPORT BOTSWANA - DURBAN)	0,450	1,250	2,200	2,750	3,25	3,450	3,450	3,450	3,450	3,450
COAL (EXPORT MAPUTO)	3,057	4,084	5,397	5,397	5,39	5,397	5,397	5,397	5,397	5,397
COAL (EXPORT RICHARDSBAY)	1,792	1,863	3,565	3,656	3,75	3,851	3,955	4,065	4,181	4,302
COAL (WATERBERG)	-	1,500							20,000	22,000
ESKOM (CAMDEN - COAL IN CONTAINERS)	1,200	2,600	4,000	5,300	5,30	5,485	5,485	5,485	5,485	5,485
ESKOM (GROOTVLEI - COAL IN CONTAINERS)	0,600	0,800								
ESKOM (MAJUBA - COAL)	7,576	9,221	14,000	14,000	14,00	14,000	14,000	14,000	14,000	14,000
ESKOM (TUTUKA COAL IN CONTAINERS)	1,751	1,809								
FERRO-CHROME (EXPORT MAPUTO)	0,105	-	0,600	0,600	0,60	0,605	0,610	0,610	0,610	0,610
IRON ORE (DOMESTIC - ORIGIN POSTMASBUR	4,920	5,013								
MAGNETITE (EXPORT MAPUTO)	3,009	5,000	6,000	6,000	6,00	6,000	6,000	6,000	6,000	6,000
MANGANESE (EXPORT PORT ELIZABETH)	4,900	6,075	6,075							
OTHER	6,182	6,511	8,169	8,405	8,62	8,908	8,987	9,334	9,575	9,503
STEEL (DOMESTIC)	0,218	0,577								
WOOD & WOOD PRODUCTS	1,836	2,073	3,044	3,154	3,39	3,495	3,662	3,791	3,924	4,059

The entire 10 year traffic demand is available on request.

ANNEXURE B

Locomotive financial impact should all programs be stopped.

1. The first submission included the following programs being stopped
   - Capex
     - 10E/1/2 Upgrade
   - Capex
     - 7E3 MOP
     - 10E MOP
     - 10E1 GO (Change to MOP)
     - 10E1 MOP
     - 10E2 MOP
     - 7E1 RETROFIT TO UPGRADE
     - 7E3 UPGRADE
     - 7E2 MOP MINOR

2. The second submission excludes the 18programs as per instruction. The 35 GO and 36 GO also excluded based on that no shunting strategy included.

   An additional 30% included in the unscheduled maintenance line as components life cycle will be exceeded.

   The impact would add an additional R615m over the ten year period.

Referenced Cerg

Locomotive tender evaluation for the supply of 599 new electric locomotives for the General Freight Business

Report of the Cross Functional Evaluation Team (Finance)

Agreed to file

M.M

6 December 2013

Mr Thamsanqa Jiyane

General Manager (CPO – TFR)

Locomotive tender evaluation for the supply of 599 new electric locomotives for the General Freight Business

Report of the Cross Functional Evaluation Team (Finance)

Purpose of Report

The purpose of this report is to detail the finance team's objectives, scope, assumptions, risks and findings from the stage 6 evaluation for the 599 electric locomotive tender.

Our understanding is that the contents of this report will be used as a basis for communication to the 1064 locomotive steering committee and the TFR Chief Executive.

Objective

The objective of the stage 6 evaluation was to determine the scoring that each bidder would obtain based upon the approved evaluation criteria for this stage.

Background

Transnet issued an RFP for the acquisition of 599 electric locomotives as was outlined in the locomotive deployment plan to ensure that TFR would be in a position to provide the required capacity in support of the MDS. TFR also has a need to modernise and upgrade its current fleet of diesel locomotives as part of the fleet is in need of replacement. As a result of the above, TFR has a requirement to procure new locomotives in the short, medium and long term.

The aim of the RFP was to elicit bids from locomotive suppliers for the proposal to supply electric locomotives (the Locomotives) in such a way so as to contribute sufficient tractive effort to support TFR's growing General Freight traffic projections in the most cost effective manner.

A Cross Function Evaluation Team (Finance) "(CFET (Finance)" was requested to assist in the evaluation of the financial and related elements of the tender submissions. Predetermined criteria, scoring and associated weightings (which were approved by the relevant authority – Transnet Board) was provided to the members of the finance team as the basis for the stage 6 financial evaluation.

Finance team

The following finance personnel were appointed by the TFR Chief Executive as the CFET (Finance) and were involved in the evaluation:

Yousuf Laher – Executive Manager, TFR Finance

Danie Smit – Deputy Treasurer Middle Office - Transnet Group Treasury

Zunaid Vally – Executive Manager, TFR Finance

Thabo Seapi – Senior Manager, TFR Finance

Mohammed Moola – Senior Manager, TFR Finance

Tsietsi Tlaletsi – Senior Manager, Transnet Group Treasury

M.M

Briefing session and bidders included in stage 6

The Supply Chain Services (TFR) ("SCS") team in the presence of Transnet Internal Audit ("TIA") briefed certain members of the team on the first day of the evaluation. The following aspects were mentioned to the CFET (Finance) in this briefing:

- The technical team required the base price to be normalised based on various options that were requested to be included as part of the locomotive technical specification;
- Six of the seven bidders made it to stage 6 and as such these six had to be evaluated as part of this stage of the evaluation. After subsequent discussions at the steering committee we were advised by SCS that as bidder 6 did not provide any technical information around a Co-co locomotive and TFR's requirement was for 599 Co-co locomotives, bidder 6 should be excluded from stage 6 of the evaluation. As such we did not conclude our evaluation of bidder 6 as there was no need to further evaluate.

The finance team were not provided with any information relating to the other bidders excluded from the 1st five rounds of the evaluation.

Bidder files, Laptop computers and CD's made available

SCS ensured that all relevant bidder files were made available to the CFET (Finance) each day. Only the relevant files were made available to the CFET (Finance).

These files remained in the control of SCS for the duration of the tender evaluation. At no point during the evaluation period were any files, documents or notes removed from the boardrooms where the evaluations were being performed. All notes, documents or spread sheets generated by the CFET (Finance) during evaluation sessions remained in the boardroom where the evaluation was conducted.

Certain technical files which contained financial information relative to the option pricing were reviewed for further information and clarity on the pricing evaluation. The reason for reviewing the technical files was as a result of bidders providing the detailed explanations and submissions for certain aspects of the price in the technical files. These files were again only reviewed in the presence of the SCS and TIA personnel.

SCS provided laptop computers with which to conduct the evaluation. All workings were conducted on these laptop computers. These laptop computers were never removed by the finance team from the boardrooms where the evaluation took place. These laptop computers remained in the possession of SCS when not in use by the finance team. CD's returned by bidders with the relevant financial information required for the evaluation was loaded onto some of these laptop computers. These laptop computers were used in the presence of the SCS and TIA personnel.

All backups of files on these laptops were kept by SCS on hard disks in a safe location.

Declarations of interest /conflicts

All CFET (Finance) members completed and signed their declarations of interest as required by SCS before the commencement of the evaluations on a regular basis. No CFET (Finance) member declared any interest in the bidders or declared any conflict of interest throughout the evaluation period.

Scope

The scope of our review was limited to evaluating the following in terms of stage 6 of the RFP and the approved evaluation criteria for this stage. As advised by SCS, the percentages and criteria listed below are the predetermined criteria as specified by the Transnet Board.

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT
		100.00%	60.00%
1	Price	30.00%	18.00%
2	Total Cost Of Ownership (TCO)	20.00%	12.00%
3	Delivery Schedule (DS)	25.00%	15.00%
4	Payment Terms (PT)	10.00%	6.00%
5	RFP & Contractual Compliance (CC)	10.00%	6.00%
6	Financial Stability (FS)	5.00%	3.00%
	TOTAL SCORE	100.00%	60.00%

There were no changes to the predetermined criteria apart from the following which requires approval of the Steering Committee and the Transnet Board:

- The "Price" evaluation criteria required hedging costs and escalations to be included. This was changed to evaluate on the basis of price excluding hedging costs and escalations (refer to the detailed explanations in the report below).

The detailed scoring criteria and scoring results are included as part of Annexure A.

- Based on a steering committee decision we were informed by SCS that our scope should be limited to the evaluation of 599 Co-co locomotives only.
- With regard to the pricing of options we were provided a list of options from CFET (Technical) for the purpose of including these items into the base price. Our scope was limited to including the prices as provided by the bidders for these technical options into the base price. We did not have access to technical files to verify that the responded technical scope included these options or not.

Technical team involvement

At certain stages during the evaluation the CFET (Finance) requested, through SCS, assistance from the technical team around aspects of:

1. The request to "normalise" the base price;
2. Conducting an evaluation of the energy models submitted as part of the TCO evaluation;
3. Reviewing the scheduled and unscheduled maintenance elements of the TCO model for reasonability.

Details of this assistance are summarised below:

1. Request to normalise the base price

   As part of the request to normalise the base price, a schedule was provided to the CFET (Finance) of items that the CFET (Technical) advised were required. In these instances, the CFET (Finance) were advised:

   - That certain bidders had provided these items as "options" in their submissions and;
   - Other bidders had indicated availability of the "options", however, the CFET (Technical) were not clear as to whether these items were appropriately costed, quoted and included in the price.

   The schedule submitted gave indications of what the CFET (Technical) expected to be done by the CFET (Finance). The detailed schedule is included as "Annexure B" of this report. In summary the following process was followed:

   - Adjust the price of the relevant bidders where bidders were not consistent in including the cost of the item in their base price;
   - Obtain pricing, for those "items" included in the schedule, from bidders who had not submitted quotes and
   - Effectively, the CFET (Finance) were required to "normalise" the base price submissions for appropriate comparison between the bidders for those options that the CFET (Technical) believed must be included in the price.

   Two members of the technical team (Christo Uys and Elvis Tshivilinge) were made available to discuss and clarify the base price "normalisation" issues. These discussions took place in the presence of SCS and TIA.

   Subsequent to the initial phase of the evaluation, clarity questions were submitted to the bidders regarding the requirements of the detailed schedule (Annexure B) from the CFET (Technical).

The CFET (Finance) used the responses received from bidders on clarification questions to conclude on the final 'Normalised Base Price'.

2. Evaluation of energy models

Five members of the technical team (Devendran Govender, Winfried Mors, Trevor Downing, Justice Ngwenyama and Chris Uys) were made available to conduct the energy model evaluation. The energy model was designed by CFET (Technical) and was fully evaluated by CFET (Technical) without the involvement of CFET (Finance). CFET (Finance) incorporated the results of the energy model evaluation into the stage 6 TCO model financial evaluation.

3. Review of the scheduled and unscheduled maintenance regimes within the TCO models as submitted by bidders

The CFET (Finance) found numerous inconsistencies in the manner in which bidders chose to complete the scheduled and unscheduled maintenance portions of the TCO model. The CFET (Finance) recommended that the CFET (Technical) review the models for reasonability with the purpose of allowing the CFET (Technical) to guide the CFET (Finance) in making decisions to score the TCO models submitted as well as to guide the CFET (Finance) in their deliberations as to whether the models submitted would actually meet the requirements to be scored fairly amongst bidders.

Four members of the technical team (Devendran Govender, Frikkie Harris, Eugene Russouw, Chris Uys) were made available to conduct a review of the scheduled and unscheduled maintenance regimes as supplied by bidders for reasonability.

Transnet Internal Audit involvement

TIA was present at evaluations sessions as requested by SCS to ensure good corporate governance. KPMG, Sekela Xabiso and Nkonki incorporated are the outsourced service provider of the Internal Audit function for Transnet.

We noted during our evaluation that KPMG were the auditors of one of the bidders.

This matter was reported to the SCS representatives present. We were advised that the process of evaluation must continue with TIA continuing to perform the oversight role for good governance.

Methodology of scoring

Scoring of points was completed using the set predetermined criteria and weightings for each section of the financial evaluation.

The process for scoring, checking and evaluating the short-listed bidders was done jointly by all members of the CFET (Finance) in the presence of SCS and TIA. All results submitted were based on consensus agreement amongst all the CFET (Finance). Yousuf Laher was a key person in the development of the evaluation model and RFP requirements, in conjunction with SCS. He outlined to all members of the CFET (Finance) the processes, procedures and methodology of scoring.

Meetings held

During the course of the evaluation, all meetings were held in the presence of SCS and TIA. These included meetings with the following parties:

- Technical (the purpose of these was to clarify issues that pertained to the technical options that required normalisation of the base price, to brief the technical team in preparation of their review of the TCO model and to receive input from the technical team around the energy model);
- Legal (the purpose of these was to advise and assist the legal representative during the contractual compliance evaluation);
- Meetings with CPO (the purpose of these meetings was mainly to provide the CPO with an update on the progress of the financial evaluation process and to obtain guidance on certain matters that required interpretation or clarification related to the RFP or other sections (Technical/SD of the evaluation).

Results of scoring

1. Price

The result of the "Price" evaluation is reflected below:

WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
			1	2	3	4	5	6	7

Price Evaluation Criteria (Escalations and hedging costs)

- The Board approved evaluation criteria supplied to the CFET (Finance) indicated that the price evaluation must be done on the basis of the price including foreign exchange hedging costs and escalations;
- The CFET (Finance) was unable to evaluate on the basis of a fixed price including escalations and hedging costs (refer explanations in the sections below);
- The price evaluation was therefore done based on the price excluding hedging and escalation costs for all bidders. The risk impact of this is outlined in the "Overall Risks" section of this report.

Escalations

- The RFP requested bidders to submit a price in line with the following options:
  - Fixed pricing;
  - Escalation based pricing;
  - Indexation formula's used in pricing calculations;

Most bidders chose the option of providing prices based on either escalation or indexation based pricing. Most of the bidders did not offer a fixed price as was required by the Board approved evaluation criteria in order to conduct the evaluation.

- It was noted that bidders provided various differing escalation regimes that were not comparable to normalise a 'Base' price over the period of the locomotive supply contract;
- Some bidders were not willing to provide fixed pricing (including escalation) over the delivery period due to the risks involved for them in this type of a pricing mechanism;

Hedging Costs

- The wording of the RFP with regard to foreign exchange hedging costs was subject to interpretation in that bidders were recommended (but not required) to provide a price including hedging costs;

- The RFP stipulated that TFR would prefer a Rand based contract and that the bidders must submit the cost of hedging and a hedging strategy. Although some bidders did provide the cost of hedging, they stated clearly that appropriate hedging strategies will be discussed and agreed upon at the contract award stage. In addition as part of their RFP response some bidders provided the cost of hedging whereas other bidders did not submit the cost of hedging;

- Through a process of clarification and in order to ensure that hedging costs were excluded from their 'Base' price, all bidders were requested to confirm whether their 'Base' prices quoted excluded foreign exchange hedging costs and if these were included to then provide the quantum thereof. Bidders were also requested to provide us with an estimated cost of hedging whether included in the Base price or not.

- As the cost of hedging will most likely change due to exchange rates fluctuating between evaluation and final contract signature date, and because the cost of hedging will in any case be base lined, checked for reasonability by Transnet Treasury, and agreed to on the date of contract signature, it would be more appropriate to exclude the cost of hedging from the evaluation at this point;

- An important point to note is that none of the bidders indicated that they were unwilling to enter into a foreign exchange hedging arrangement with TFR at the time of contract signature;

Final agreed evaluation methodology (escalation & hedging costs)

- In order to proceed with the price evaluation on a consistent and fair basis, the CFET (Finance) agreed, after consultation with SCS, that it would be more appropriate to exclude escalations and hedging costs from the price evaluation and thereby attain a more normalised price for evaluation purposes. This was agreed to with SCS on the proviso that this change to the evaluation methodology be brought to the attention of the steering committee and Transnet Board for approval prior to the award of the contract;

Normalising the "Base" Price for evaluation

Technical Options

- The 'Base' price, as submitted by all bidders was normalised for the "technical option" items as requested by the technical evaluation team. Refer "Annexure B" which contains a list of all option items that were normalised;

- The provisioning of ECP/WDP and RDP was a mandatory requirement per the technical specifications. Based on our discussions with CFET (Technical), all bidders have confirmed, in the technical response that they fully complied with

this requirement. It was therefore concluded that all bidders had included the cost of provisioning in their base price and no adjustment to this item was required for evaluation purposes.

- The cost of either ECP/WDP or RDP was included in the base price, as the CFET (Technical) have advised that it is probable that this option would be exercised. We were advised by the GM Logistics Integrator (Pragasen Pillay) as to the number of ECP/WDP, RDP or ECP/WDP/RDP combination that must be applied over the fleet. (refer Annexure B for allocation and associated cost of this split);

- All bidders included the provisioning of ECP/WDP or RDP into their price; however only bidder 2 included the equipment cost in their base price. Based on the advice from CFET (Technical) we therefore included the equipment cost of ECP/WDP and RDP for all other bidders into their base price for the purpose of normalising the base price.

Rebasing the price for foreign exchange differences

- The RFP did not indicate the date that bidders should use to convert foreign exchange as part of the imported content of their price. As such bidders made their own assumptions and each used a rate and date of their choice. The result of this is that a comparison of base prices with different dates and rates would be inconsistent. In order to normalise the price for changes due to foreign exchange differences and movements since RFP closing date, the CFET (Finance) normalised the prices based on exchange rates as at 11th November 2013 (USD/ZAR 10.37, EUR/ZAR 13.91, JPY/ZAR 0.10457). As a consequence bidders were requested in a clarity question to confirm their foreign currency components included in their 'Base' price. These foreign currency components were converted at spot rates on the 11th of November 2013 for the purpose of comparing prices between bidders.

Using TE as a main subcontractor

- The RFP part 2 dictates as follows "participation of TRE in this locomotive procurement process will be prescribed". In terms of the evaluation governance process CFET (Finance) does not have access to 'Supplier Development' files. As such CFET (Finance) assumed that all bidders have provided pricing based on the utilisation of TE as the main subcontractor; "

- SCS however advised CFET (Finance) that the Supplier Development files submitted by bidders indicated that Bidder 3 & Bidder 7 did not specify the use of TE as the main subcontractor and that this could have a potential price adjustment implication. SCS also mentioned that bidders were likely to make different assumptions in the use of TE as a main subcontractor including the percentage that would be subcontracted. These assumptions which were not specified by TFR in the RFP process could differ significantly between bidders

Accordingly SCS subsequently decided to obtained/~~seek~~ clarity from bidders on this matter;

- SCS in conjunction with the TFR CE and Transnet GCE and GCFO decided that clarity should only be obtained from those bidders who included TE as a main subcontractor. The clarity request was to establish what proportion of the bidder's price related to the use of TE;
- Accordingly the methodology provided to the CFET (Finance) was that all bidders should be evaluated excluding the use of TE as a main subcontractor in order to normalise the base on which to evaluate price;
- Based on this decision clarity responses were only issued to Bidder 1, Bidder 2 and Bidder 5 (those bidders who indicated the use of TE as a subcontractor);
- Clarity responses were received from these bidders who indicated the impact on price and the new bid price for 599 COCO locomotives if TE was not used as subcontractor. The summary of these responses is as follows:
    - Bidder 1 provided the required information as requested and indicated that the impact of using TE as a subcontractor would be a decrease in price of R 1 905 514;
    - Bidder 5 provided the required information and indicated that there would be no impact on the bid price per locomotive if TE was not used as a subcontractor;
    - Bidder 2 provided the required information, however we noted that their new submitted bid price excluding TE as a subcontractor did not reconcile to their original bid price. The difference noted was R 2 010 000 per locomotive. This posed a risk to the evaluation of the price and the CFET (Finance) subsequently consulted with SCS to explain the concern as the impact of this difference was significant in relation to the final scoring on price;
- It was subsequently decided by SCS that further clarity from Bidder 2 was required to understand this difference. SCS together with a representative of the finance team and in the presence of TIA engaged Bidder 2 telephonically on the evening of the 4 December 2013 to discuss this un-reconciled difference;
- Bidder 2 indicated that the difference related to a 'Discount' offered on the original price. It was then mentioned to Bidder 2 that this was not what the clarity had sought and that their new bid price should not reflect in anyway further discounts offered by them at this stage. Subsequent to this telephonic conversation Bidder 2 submitted a new clarity. It was however noted that this clarity seemed to have reflected the 'Discount' into the TE portion of the new bid price. Bidder 2 originally submitted a reduction in price due to TE portion of R 3 480 000 per locomotive and the subsequent submission from them indicated it to be R 5 490 000 per locomotive;

- CFET (Finance) then further engaged SCS to provide guidance on this issue as we were unable to determine the appropriate way forward. The main concern from the CFET (Finance) was the uncertainty of whether or not Bidder 1 may have subsequently included this 'Discount' portion of R 2 010 000 into their price thereby having the potential impact of unfairly prejudicing other bidders in the evaluation process;

- The CFET (Finance) was advised by SCS that based on discussions with the GCE and the GCFO that the evaluation should proceed on the basis excluding this potential discount and as such the CFET (Finance) utilised a reduction in price of R 3 480 000 for the evaluation;

- The CFET (Finance) subsequently completed the evaluation on this basis;

- In summary the impact of excluding TE from the normalised base price is as follows:

Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
-1 905 514	-3 480 000	0	n/a	0	n/a	0

- The normalised pricing used for evaluation purposes of all bidders (capital acquisition cost) excluding TE as the main subcontractor i.e. using private sector as the ~~main~~ subcontractor is summarised as per the table below;

Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
32 833 423	34 716 188	46 301 906	n/a	38 091 755	n/a	33 695 001

Assumptions used for pricing

Other than as noted above the following additional assumptions were used by the CFET (Finance) in the price evaluation:

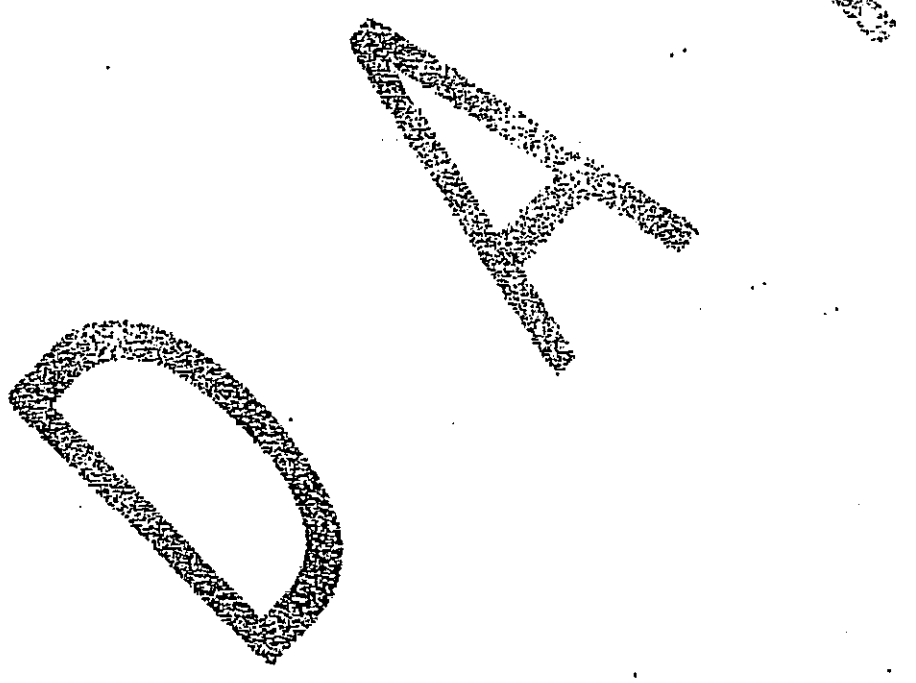
- Where the import content percentage was not supplied by bidders as part of their pricing proposal and or clarification then the local content declaration form as supplied by bidders was used to obtain the imported content;

- The RFP requested break point pricing for batches of locomotives. As the TFR requirement is for 599 locomotives, the CFET (Finance) used the pricing provided by bidders for 599 locomotives to conduct the evaluation;

- Bidder 7 offered an additional discount of R 120 000 per locomotive for the Bo-bo locomotive, which was not considered as the evaluation was done for Co–o's and no additional discount was offered for Co-co's;

- The price of a standard list of capital spares and spare parts was requested as part of the RFP, to be included in the acquisition cost of the locomotive. Where bidders added additional items to this list of capital spares and spare parts then these items were excluded for evaluation purposes in order to ensure that the bidders were evaluated on the standard list thereby ensuring the evaluation was performed on an "like for like" basis. In instances where a bidder did not provide a price for a capital spare or spare part as per the standard list, then an average price of the remaining bidders was used to ensure that a realistic comparison was achieved;

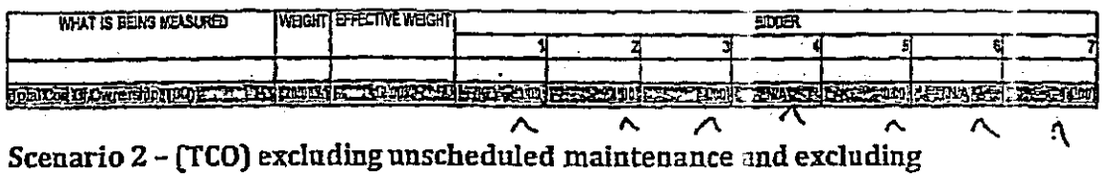
- The Bonus points for Value Added services were not assessed. The main factor for this decision is that this item was not clearly defined in the RFP and the technical team had no view of the requirement of "value add" aspects and the technical team was not allowed to have access to the financial files. Therefore the finance team could not assess value added services;



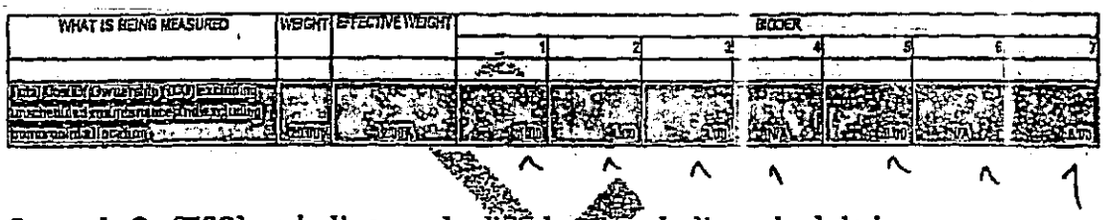
million kilometres) not be reached then the penalty clauses would come into effect;

The results of the "TCO" evaluation scenarios are reflected below:

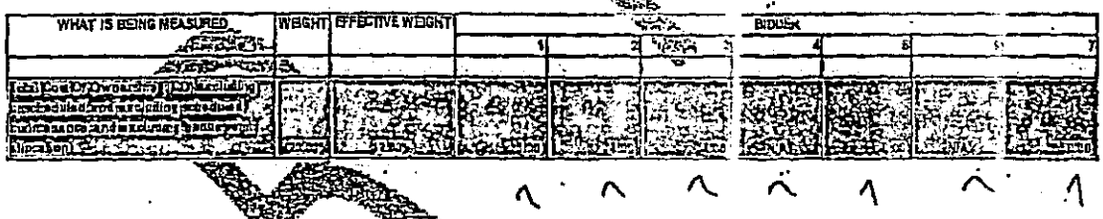
Scenario 1 – all elements of TCO included:



Scenario 2 – (TCO) excluding unscheduled maintenance and excluding bonus point allocation



Scenario 3 - (TCO) excluding unscheduled and excluding scheduled maintenance and excluding bonus point allocation



2. Total Cost of Ownership (TCO)

TCO evaluation criteria

The evaluation of TCO is conducted based on the following five elements (total 20 points):

i. scheduled maintenance (8 points);
ii. lost revenue (4 points);
iii. unscheduled maintenance (4 points);
iv. energy utilisation (4 points);
v. overall TCO result bonus points (2 points);

Points are allocated individually for each of the five elements above.

- Whilst reviewing the submissions received from bidders on the TCO model, we noticed that the results of the scheduled and unscheduled maintenance varied considerably. The CFET (Finance) was unable to ascertain whether these varied results were as a result of bidders' interpretations of the TCO model or as a result of the different maintenance regimes of their respective locomotives. The result of this is that the evaluation of the scheduled and unscheduled maintenance could be subjective. The items that contribute to the subjectivity are as follows:
  i. bidders used different labour rates;
  ii. bidders used different prices for similar components;
  iii. bidders assumed different types of maintenance regimes and
  iv. bidders assumed different failure rates for unscheduled maintenance;

- Through discussions with CFET (Technical), we were however advised that the above could be normalised by CFET (Technical), if required;

- The matter was discussed together with SCS and CFET (Technical) and it was decided that due to the subjectivity of this item, and because we did not want to make assumptions to change bidders submissions, different scenarios including and excluding scheduled and unscheduled maintenance should be prepared to provide the Steering Committee with appropriate information to make a final decision;

- As per confirmation from CFET (Technical) all bidders confirmed as part of their technical submission, that they would meet the required reliability regime i.e. that the locomotives offered would achieve less than 15 faults per million kilometres. This contributes to reducing the risk of an unreliable locomotive and as such provide some comfort should the unscheduled maintenance be excluded from the TCO evaluation. The draft supply agreement includes a penalty regime whereby should the stated minimum reliability regime (15 faults per

Assumptions used for TCO model evaluation

- The TCO model as submitted by all bidders was used as the basis for the evaluation;
- Escalation was normalised for all bidders for purposes of appropriate comparison. CPI + 2 % was used as escalation for all bidders. CPI was obtained from the current year's budget guidelines;
- The WACC rate was obtained from the latest Group Financial Planning Policy issued on the 1st of August 2012, and was used for the present value calculations;
- The submissions by bidders in respect of failure rates, maintenance strategies, optional components requiring unscheduled replacement and the timing of maintenance interventions varied significantly, however, as a finance team we assumed that these submissions are relative to their locomotive/product type as well as their maintenance regime and strategies. Accordingly we used the TCO models as submitted by bidders to conduct the evaluation;
- For the purposes of evaluating lost revenue as part of the TCO evaluation we assumed that TFR's expected delivery schedule would be an equal number of locomotives per month, as per the delivery batches stipulated within the relevant years within the RFP. The current average TFR leasing rates per day was used to determine the lost revenue value for all bidders. The lease revenue rate per day used for all bidders was R 24 632 per locomotive;

  The energy model was designed by CFET (Technical) and was fully evaluated by CFET (Technical) without the involvement of CFET (Finance). CFET (Finance) incorporated the results of the energy model evaluation into the stage 6 evaluation of TCO;
- Some bidders included extra optional components for unscheduled maintenance which other bidders have not included in their TCO model. We have not removed this from the TCO model as suppliers would know the unscheduled maintenance costs of their loco's best;
- The cost of major components and materials as submitted in the TCO models of bidders 5 & 7 looked abnormally low; this was clarified as part of the clarification request submitted to these bidders. Both bidders confirmed post clarification that the amounts quoted were correct.

3. Delivery schedule

The result of the "Delivery" evaluation is reflected below:

WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
			1	2	3	4	5	6	7
Delivery Schedule	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

<u>Assumptions used for delivery schedule evaluation</u>

- The effective date of contract signature was normalised to 1 September 2013 for all bidders in order to ensure consistent scoring;
- The RFP closing date was extended by about 7 months from 16 October 2012 to 30 April 2013. As such, for the purpose of evaluation, the expected start date for delivery (previously March 2014) was aligned accordingly and was moved forward by 7 months for all bidders (October 2014);
- Where bidders provided an accelerated delivery schedule whereby they would deliver earlier than indicated in the RFP, and would complete delivery of all 599 locomotives earlier than expected in the RFP, then these bidders were allocated the full points applicable for delivery for each subsequent year after their delivery is fully completed;
- TFR would conduct acceptance tests prior to accepting locomotives. The length of time taken to conduct acceptance testing is completely under the control of TFR. Bidders were not advised how long this acceptance testing would take within the RFP. As such bidders made their own assumptions regarding the time taken to conduct acceptance testing. In order to ensure consistency, the delivery date as stipulated by bidders was used to conduct the evaluation instead of the acceptance date;
- Some bidders provided an alternative delivery schedule based on more "imported content" This option was not considered in any of the team's evaluations as the preferred position is to maximise local content;

- The delivery schedules of all bidders is summarised as per the table below:

	Oct 15	Oct 16	Oct 17	Oct 18	Oct 19	Beyond	Total
Per RFP	65	130	130	130	144	0	599
Bidder 1	73	159	164	164	39	0	599
Bidder 2	16[illegible]	142	146	145	0	0	599
Bidder 3	0	81	151	155	153	59	599
Bidder 5	20	133	130	130	138	43	599
Bidder 7	9	103	135	135	135	8[illegible]	599

The above delivery schedule assumes a contract effectiveness date of 1 September 2013. The delivery schedule above would move out by an equal number of months from 1 September 2013 to the actual date the contract is signed.

4. Payment terms

The result of the "Payment Terms" evaluation is reflected below:

WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	2	3	4	5	6	7
Payment terms [illegible]	[illegible]	[illegible]	[illegible]10.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible] N/A	[illegible]10.00

Assumptions used in payment term evaluation

- The approved evaluation criteria required the evaluation of payment terms on a Net Present Value (NPV) basis. Therefore cash flows needed to be constructed for all bidders using their declared payment terms. Cash flows are generally a factor of payment terms, delivery dates, discount rate and a price. As "price" and "delivery" are evaluated separately as part of this stage 6 evaluation, the CFET (Finance) standardised the price per loco (R 31 million) and the delivery schedule (as per the RFP) for all bidders for the "payment terms" portion of the stage 6 evaluation. This would have the effect of isolating the payment terms offered by bidders on the cash flows for evaluation purposes. The primary reason for this is to ensure that bidders who provide higher/lower prices and/or faster/slower delivery schedules are not benefited or penalised twice in the evaluation process;

- The draft supply agreement issued as annexure I of the RFP stipulated a different % preferred payment terms for TFR as compared to the preferred payment terms stipulated in the RFP. After discussion with SCS we were advised

that bidders were advised through a clarification that the preferred payment terms of TFR is as stipulated in the RFP. Where payments terms conflicted between the RFP response and the supply agreement response the payment terms as offered by bidders in response to the RFP was used for the evaluation purposes;

- Where bidders provided a percentage for the deposit payment, we applied that percentage to the standardised price to determine the deposit payment, whereas where bidders provided a fixed Rand amount we utilised that fixed Rand amount as a deposit payment on the standardised price;

- The WACC rate (12.56%) was obtained from the latest Group Financial Planning Policy issued on the 1st of August 2012, and was used for the present value calculations;

- We used a standardised retention period of 6 months from acceptance date for all bidders. The reason for this is that some bidders had indicated retention period to be when availability and reliability targets are achieved which could vary and can depend on various factors.

- The payment terms of all bidders is summarised as per the table below:

	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5
Deposit on effective date	8%	1.62%	1.62%	1.62%	1.62%
Milestone 2	8%		9.00%		
Milestone 3	8%		3.00%	0.00%	
Milestone 4			3.00%		
Milestone 5			5.00%		
Milestone 6			3.00%		
Total payments before acceptance	24.00%	1.62%	24.62%	1.62%	1.62%
On at locomotive acceptance	66%	88.38%	65.38%	98.38%	88.38%
Retention	10%	10.00%	10.00%	0.00%	-
Total	100.00%	100.00%	100.00%	100.00%	100.00%

- A detailed explanation as to how the scoring was arrived at is attached as Annexure D of this report.

5. RFP & Contractual Compliance

The result of the "RFP & Contractual Compliance" evaluation is reflected below:

WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
			1	2	3	4	5	6	7
RFP & Contractual Compliance	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

- Evaluation of the contractual compliance matters related to the responses to the draft supply agreement by bidders was completely evaluated by Mr Kenneth Diedricks (TFR General Counsel) from the TFR legal department. CFET (Finance) incorporated the results of the contractual compliance evaluation into the stage 6 evaluation of RFP & Contractual Compliance;

- Evaluation of the RFP compliance matters related to the administrative responsiveness to the RFP by bidders was evaluated by Ms Lindiwe Mdletshe from the TFR SCS department. CFET (Finance) incorporated the results of the RFP compliance evaluation into the stage 6 evaluation of RFP & Contractual Compliance;

- References were provided by all bidders and therefore SCS assumed these to be adequate and scored full marks for all bidders. We were advised by SCS that they would contact references provided once a preferred bidder is chosen.

6. Financial Stability

The result of the "Financial Stability" evaluation is reflected below:

WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
			1	2	3	4	5	6	7
Financial Stability	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

- The financial stability of the bidders was assessed as part of stage 2 of the evaluation process. Please refer to the CFET (Finance) report relating to stage 2 issued on 31st July 2013. The scoring from stage 2 was carried forward to stage 6 of the evaluation.

OVERALL RISKS

The following risks must be communicated to the steering committee and considered prior to final contract award:

Price

Hedging & escalation

- The evaluation and scoring for pricing has been determined and explained above. The CFET (Finance) would like to bring to the attention of the steering committee that as a result of the evaluation of price on the basis of excluding hedging costs and escalation costs, that the following additional aspects be considered prior to awarding the contract. These factors when considered either individually or in combination could have a significant impact on the final negotiated price:

  i. Hedging;
  ii. Escalation;
  iii. Break pricing;

  A summary of the potential impact of the items above on the evaluated price is summarised below in order to provide the steering committee with a better understanding:

Hedging

Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Per Loco	Per Loco	Per Loco	n/a	Per Loco	Per Loco	Per Loco
2 448 500	2 367 000	- 6 662 297	n/a	5 552 645	n/a	4 743 768

Escalations

Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Per Loco	Per Loco	Per Loco	n/a	Per Loco	Per Loco	Per Loco
13 794 150	2 613 000	12 878 150	n/a	0	n/a	9 004 768

Break point price

- As the TFR requirement is for 599 locomotives, the CFET (finance) used the pricing provided by bidders for 599 locomotives to conduct the evaluation. Break point pricing was provided by all bidders and the price per locomotive varies dependant on the batch size of the order placed. This must be considered should TFR decide to place an order for a smaller batch as the evaluation was not conducted based on smaller batches. A decision regarding whether smaller batches will be purchased has not yet been made and therefore was unknown at the time of the evaluation. The table below indicates the break point pricing offered by bidders (based on their original tender responses where bidders used the main subcontractor of their choice):

? Schedule for file?

Break point price table

	Batch 1	Batch 2	Batch 3	Batch 4	Batch 5
Bidder 1	49 860 694	37 247 559	34 555 142	33 245 507	30 95[illegible] 000
Bidder 2	42 500 732	36 462 977	35 255 426	34 737 905	34 38[illegible] 000
Bidder 3	81 168 577	51 030 239	45 006 189	42 355 684	39 90[illegible] 949
Bidder 5	51 359 000	37 338 000	34 175 000	32 575 000	31 35[illegible] 000
Bidder 7	51 264 417	42 438 403	39 742 636	37 201 313	29 83[illegible] 000
Locos per year	65	130	130	130	144
Locos cumulative	65	195	325	455	599

TE as a subcontractor

- With reference to the section of the report above dealing with TE as the ~~main~~ subcontractor and the impact on price, the following matters need to be considered by the steering committee:

- Although the price has been normalised to exclude TE for evaluation purposes, the use of TE as a main subcontractor is highly probable as this is a requirement as per the PFMA approval letter from the DPE. As such prices will have to be negotiated with the preferred bidder/s including TE and thus needs to be considered by the steering committee prior to the conclusion of the evaluation process as this could have an impact on the final price.

- The price that bidders provided based on their choice of sub-contractor is significantly different from the price used for evaluation purposes (where the incremental cost of TE was excluded). This could change the evaluation result and the final price contracted.

- Bidder 3 and Bidder 7 have not quoted using TE as ~~the main~~ subcontractor. No clarity was obtained from these bidders as mentioned in the report above. If clarity was obtained from these two bidders and they indicated that there is no change to their price whether TE will be used or not (as was the response from Bidder 5) then the impact on the evaluation scoring result could be significant.

- In addition it should be noted that should Bidder 3 or 7 become the preferred bidder, then there is a risk of a potential price adjustment and possible protracted negotiations. The finance team was unable to reasonably quantify the quantum of this potential price adjustment. It should be further noted that the use of TE as the sub-contractor could be an incremental adjustment to Bidder 3 or 7's price based on the differential between using TE as a subcontractor versus the subcontractor costs already included in the price of Bidder 3 or 7's submission.

- The delivery regime that bidders provided was based on their choice of sub-contractor (some with TE and some using private sector subcontractors). This could change should bidders be required to use TE as a sub-contractor. A different delivery schedule could have an impact on the evaluation result and the final delivery schedule contracted.

M.M

Impact of capital and maintenance spares on price

- Standardised quantities of capital spares required were provided to all bidders as part of the RFP. All bidders quoted for these capital spares based on the quantities provided and this has been included in the price of the locomotive used for evaluation purposes. Following discussions with CFET (Technical) we were advised that as failure rates of these capital spares is not yet known, the quantities requested may not be completely accurate at this point and may change once the locomotives are placed into production;

- Quantities of maintenance spares required were provided by bidders as part of the RFP. All bidders quoted for these maintenance spares based on their knowledge of historical failure rates and this has been included in the price of the locomotive used for evaluation purposes. Following discussions with CFET (Technical) we were advised that as failure rates of these spares is not yet known by TFR, the quantities provided may not be completely accurate at this point and may change once the locomotives are placed into production.

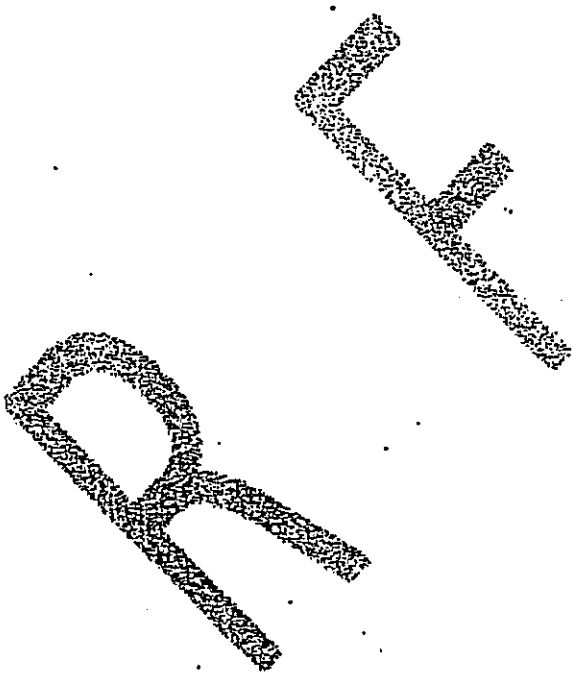
TCO Model

The maintenance and intervention regimes of the selected preferred bidder must receive significant scrutiny during the negotiation phase. The CFET (Technical) will be required to have a detailed understanding of the related submissions and should conduct the necessary reviews and assessments of the maintenance and intervention regimes of the selected bidder.

We would recommend that a clause be inserted into the supply contract whereby a penalty is imposed upon the supplier for higher actual TCO costs as compared to their tender submission. This penalty clause can be built in on the basis of a periodic review (possibly every 5 years) of the actual energy usage, scheduled and unscheduled maintenance costs of the locomotives as compared to their tender submissions.

Delivery schedule

Some bidders' delivery schedules differed significantly from the requirements of Transnet. Although these bidders would score relatively low points in this area of scoring, the overall scoring may still be high due to other scoring criteria being taken into account like price, TCO, payments terms etc. Should any of these bidders be awarded a preferred bidder status it would be critically important for TFR to understand the committed delivery schedule based on their bid response. This could significantly impact the outcome of negotiations with these bidders. The delivery schedule reflected in this report assumes a contract effectiveness date of 1 September 2013. This delivery schedule would move out by an equal number of months from 1 September 2013 to the actual date the contract is signed.



MATTERS FOR APPROVAL OF THE STEERING COMMITTEE

The CFET (Finance) requests as part of this evaluation and based on the contents of the report above the:

1. Approval of the price evaluation criteria on the basis of excluding hedging and escalation costs;
2. Approval of all assumptions used for scoring as outlined in this report;
3. Approval of the TCO scenario to be used for final evaluation.
4. Approval of the price methodology provided to the CFET (Finance) for evaluation purposes to exclude the impact of TE on price.

CONCLUSION

Based on the scoring by the CFET (Finance) using the assumptions mentioned above, the following is a summary of the results of our evaluation:

Scenario 1 – all elements of TCO included

FINANCIAL EVALUATION - FINANCIAL SUMMARY

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	2	3	4	5	6	7
1	Price	30.00%	18.00%	30.00	10.00	0.00	N/A	0.00	N/A	20.00
2	Total Cost Of Ownership (TCO)	20.00%	12.00%	3.00	4.00	4.00	N/A	0.00	N/A	14.00
3	Delivery Schedule (DS)	25.00%	15.00%	25.00	25.00	6.00	N/A	6.00	N/A	4.00
4	Payment Terms (PT)	10.00%	6.00%	0.00	10.00	1.00	N/A	9.00	N/A	10.00
5	RFP & Contractual Compliance (CC)	10.00%	6.00%	8.76	9.00	6.25	N/A	8.50	N/A	8.25
6	Financial Stability (FS)	5.00%	3.00%	3.00	3.00	2.50	N/A	2.88	N/A	2.38
	TOTAL SCORE	100.00%	60.00%	69.75	61.00	19.75	N/A	26.38	N/A	58.63
	EFFECTIVE SCORE AT 60%			41.85	36.60	11.85	N/A	15.83	N/A	35.18

Scenario 2 – (TCO) excluding unscheduled maintenance and excluding bonus point allocation

FINANCIAL EVALUATION - FINANCIAL SUMMARY

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	2	3	4	5	6	7
1	Price	30.00%	18.00%	30.00	10.00	0.00	N/A	0.00	N/A	20.00
2	Total Cost Of Ownership (TCO)	20.00%	12.00%	1.00	4.00	4.00	N/A	0.00	N/A	8.00
3	Delivery Schedule (DS)	25.00%	15.00%	25.00	25.00	6.00	N/A	6.00	N/A	4.00
4	Payment Terms (PT)	10.00%	6.00%	0.00	10.00	1.00	N/A	9.00	N/A	10.00
5	RFP & Contractual Compliance (CC)	10.00%	6.00%	8.75	9.00	6.25	N/A	8.50	N/A	8.25
6	Financial Stability (FS)	5.00%	3.00%	3.00	3.00	2.50	N/A	2.88	N/A	2.38
	TOTAL SCORE	100.00%	60.00%	67.75	61.00	19.75	N/A	26.38	N/A	52.63
	EFFECTIVE SCORE AT 60%			40.65	36.60	11.85	N/A	15.83	N/A	31.58

Scenario 3 - (TCO) excluding unscheduled and excluding scheduled maintenance and excluding bonus point allocation

FINANCIAL EVALUATION - FINANCIAL SUMMARY

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	2	3	4	5	6	7
1	Price	30.00%	18.00%	30.00	10.00	0.00	N/A	0.00	N/A	20.00
2	Total Cost Of Ownership (TCO)	20.00%	12.00%	1.00	4.00	4.00	N/A	0.00	N/A	0.00
3	Delivery Schedule (DS)	25.00%	15.00%	25.00	25.00	6.00	N/A	6.00	N/A	4.00
4	Payment Terms (PT)	10.00%	6.00%	0.00	10.00	1.00	N/A	9.00	N/A	10.00
5	RFP & Contractual Compliance (CC)	10.00%	6.00%	8.75	8.00	6.25	N/A	8.50	N/A	8.25
6	Financial Stability (FS)	5.00%	3.00%	3.00	3.00	2.50	N/A	2.38	N/A	2.38
	TOTAL SCORE	100.00%	60.00%	67.75	61.00	19.75	N/A	26.38	N/A	44
	EFFECTIVE SCORE AT 60%			67.50	61.00	19.75	N/A	26.38	N/A	26.78

Yousuf Laher
Executive Manager, Finance

Danie Smit
Executive Manager, Transnet Treasury

Zunaid Vally
Executive Manager, Finance

Thabo Seapi
Senior Manager, Finance

Tsietsi Tlaletsi
Senior Manager, Finance

Mohammed Moola
Senior Manager, Finance

Annexure A

Detailed Scoring Criteri[illegible] and Allocated Points

Price:

FINANCIAL EVALUATION: FINANCIAL SUMMARY										
	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
				1	2	3	4	5	6	7
[illegible]										
				Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
				Unacceptable	Unacceptable	Unacceptable	n/a	Unacceptable	Unacceptable	Unacceptable
				100 % Co-Co	100 % Co-Co	100 % Co-Co	n/a	100 % Co-Co	n/a	100 % Co-Co
1.1	Lowest Technically Acceptable Capital Acquisition Cost (LTACAC) (refer TCO model) including duties or customs, escalations, insurances, engineering support, special tooling and test equipment costs, capital spares costs, consumables, Set up costs, Spares costs and working holding cost, forex hedging costs) per loco									
	Bidder with lowest price & or any bidder within 0.99% of LTACAC	30		32 833 423	34 718 188	45 301 995	n/a	38 081 755	n/a	33 695 001
	any bidder within 1% to 1.99% of LTACAC	25								
	any bidder within 2% to 2.99% of LTACAC	20								
	any bidder within 3% to 4.99% of LTACAC	15								
	any bidder within 5% to 7.99% of LTACAC	10								
	any bidder within 8% to 12.99% of LTACAC	5								
	>13% of LTACAC	0								
	% result			0.00%	5.73%	41.02%	n/a	16.02%	n/a	2.62%
	Final Score			30	10	0	n/a	0	n/a	20
1.2	Value added - 1 extra Bonus point									
	Value Add Services included in LTACAC to the value of > R 200 k per loco eg: Free Software & upgrades to software Free lifting & replacement of parts etc.	1								
	% result									
	Final Score			Note 1	Note 1	Note 1	Note 1	Note 1	Note 1	Note 1

Note that the maximum points available is 30 including the bonus point

Notes:

1 The Bonus points for Value Added services was [illegible] assessed . The main factor for this assumption is that these items are not clearly defined in RFP and the technical team had no view of the requirement of "value add" aspects. Therefore the technical team did not have the relevent expertise to assess value added services

2 Note: escalations and forex hedging costs were excluded from the price evaluation - refer notes in detailed evaluation sheet.

3 The main subcontractor per the SD files. The Price evaluation has been done on the basis of excluding the cost of using TE as the main subcontractor but rather bidders were requested to quote as if another private sector subcontractor is used (per the GCS request) this was requested via clarification from bidder 1,2 & 5). SCS issued the clarifications to those bidders that indicated that they had used TE as

Annexure A – Detailed scoring criteria and allocated points - TCO

FINANCIAL EVALUATION - FINANCIAL SUMMARY										
	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
				1	2	3	4	5	6	7
[illegible]	Total Cost Of Ownership (TCO) [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	N/A	[illegible]	N/A	[illegible]
[illegible]	Total Cost Of Ownership (TCO) [illegible] bonus points [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	N/A	[illegible]	N/A	[illegible]
[illegible]	Total Cost Of Ownership (TCO) [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	N/A	[illegible]	[illegible]	[illegible]

Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
100 % Co-co	100 % Co-co	100 % Co-co	n/a	100 % Co-co	100 % Co-co	100 % Co-co

1.1 Lowest Total cost of Ownership (LTCO) - NPV - for preventative/scheduled maintenance only (excluding corrective maintenace, lost revenue & energy)

Criteria	Points	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Lowest LTCO & any bidder within 1.99% of LTCO	8	4 221 721	33 334 355	7 559 120	n/a	3 757 408	n/a	2 825 026
any bidder within 1% to 1.99% of LTCO	6							
any bidder within 2% to 2.99% of LTCO	4							
any bidder within 3% to 7.99% of LTCO	2							
any bidder within 8% to 12.99% of LTCO	1							
> 13% of LTCO	0							
% result		61%	1171%	183%	n/a	43%	n/a	
Final Score		0	0	0	n/a	0	n/a	0

1.2 Lost Revenue - Opportunity cost

Lowest Lost Revenue (LLR) - NPV

Criteria	Points	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Lowest LLR & any bidder within 0.99% of LLR	4	-1 182 184 049	-2 764 614 857	2 123 457 800	n/a	1 025 183 607.21	n/a	1 801 242 599
any bidder within 1% to 1.99% of LLR	3							
any bidder within 2% to 3.99% of LLR	2							
any bidder within 4% to 12.99% of LLR	1							
>13% of LLR	0							
% result		-59%	0%	-175%	n/a	-137%	n/a	-163%
Final Score		0	4	0	n/a	0	n/a	0

1.3 Corrective/unscheduled maintenance plan

Lowest technically acceptable corrective maintenance cost of Ownership (LTACMCO) - NPV - corrective maintenance (excluding energy and preventative maintenance)

Criteria	Points	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Lowest LTACMCO & within 1.99% of LTACMCO	[illegible]	1 816 918	591 852	2 202 691	n/a	2 148 485	n/a	8 523
within 2% to 4.99% of LTACMCO	[illegible]							
within 5% to 7.99% of LTACMCO	[illegible]							
within 8% to 12.99% of LTACMCO	[illegible]							
> 13% of LTACMCO	0							
% result		21217%	6845%	25743%	n/a	25107%	n/a	0%
Final Score		0	[illegible]	[illegible]	n/a	0	n/a	[illegible]

1.4 Energy

Lowest technically acceptable energy cost (LTEC) - NPV - (excluding corrective and preventative maintenance)

Criteria	Points	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Lowest LTEC & within 0.99% of LTCO	4	8 025 462	9 312 958	7 150 585	n/a	8 460 083	n/a	11 302 230
within 1% to 1.99% of LTEC	3							
within 2% to 3.99% of LTEC	2							
within 4% to 12.99% of LTEC	1							
>13% of LTEC	0							
% result		12.2%	30.2%	0%	n/a	18.3%	n/a	58.1%
Final Score		[illegible]	[illegible]	[illegible]	n/a	0	n/a	[illegible]

1.5 Bonus Points - overall lowest NPV for TCO (excluding lost revenue)

Criteria	Points	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
Lowest overall NPV & within 0.99% of lowest overall NPV	2	14 066 100	43 236 275	16 912 404	n/a	14 363 974	n/a	13 938 178
within 1% to 2.99% of lowest overall NPV	1							
>2.99% of lowest overall NPV	0							
% result		0.92%	210.61%	21.35%	n/a	3.08%	n/a	0.0%
Final Score		2	0	[illegible]	n/a	0	n/a	2

Note that the maximum points available is 20 including the bonus point

Notes:

1 We used the TCO calculations as provided by bidders. Bidders could (not that they have) miscalculate and reflect a low lifecycle cost. This could expose TFR to risk of higher life cycle costs than that which was used for evaluation.
We recommend that a penalty clause is built into the contract to mitigate the risk of exposure of changes in the TCO over the life of the asset.

2 Some bidders included extra optional components for unscheduled maintenance which other bidders have not included. We have not removed this from the TCO model as suppliers would know the unscheduled maintenance costs of their loco's best.

Annexure A

Detailed Scoring Criteria and Allocated Points

Delivery

FINANCIAL EVALUATION - FINANCIAL SUMMARY										
	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
				1	2	3	4	5	6	7
3	Delivery Schedule (DS)	25.00%	25.00%	25.00	25.00	25.00	N/A	6.00	N/A	25.00

New GF3 Electric Locomotive Plan

Delivery Periods	2014/15	2015/16	2016/17	2017/18	2018/19	Total
Quantity of Locomotive	65	130	130	130	144	599

	Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
	Unescalated	Unescalated	Unescalated	N/A	Unescalated	Unescalated	Unescalated
	100 % Co-co	100 % Co-co	100 % Co-co	N/A	100 % Co-co	100 % Co-co	100 % Co-co
Final Score	25	25	6	N/A	6	N/A	4

3.1 Cumulative Number of loco's delivered on time each year	Points
65 loco's by March 2015	3
195 loco's by March 2016	3
325 loco's by March 2017	3
455 loco's by March 2018	3
599 loco's by March 2019	3
Total points	15
3.2 Number of loco's delivered on time each year	
65 loco's during Financial Year March 2015	
130 loco's during Financial Year March 2016	2
130 loco's during Financial Year March 2017	
130 loco's during Financial Year March 2018	2
144 loco's during Financial Year March 2019	2
Total points	10
Total scoring is out of 25	25

Annexure A

Detailed Scoring Criteria and Allocated Points

Payment Terms:

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	BIDDER 2	BIDDER 3	BIDDER 4	BIDDER 5	BIDDER 6	BIDDER 7
[illegible]	Payment Terms (PT) [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	N/A	9.00	N/A	10.00
				Bidder 1	Bidder 2	Bidder 3	Bidder 4	Bidder 5	Bidder 6	Bidder 7
				Unescalated	Unescalated	Unescalated	N/a	Unescalated	Unescalated	Unescalated
				100 % Co-cd	100 % Co-cd	100 % Co-cl	N/a	100 % Co-cd	100 % Co-cd	100 % Co-co
	Final Score			[illegible]	10	[illegible]	N/A	9	N/A	10

Payment terms are usually based on:
- Pre-payment (%)
- Milestones
- Acceptance of Locos
- Retentions

4.	Cash Flow - Time Value of money	
	Best payment terms from a time value of money perspective & within 0.99 % of best payment terms	10
	Within 1 to 1.99 % of the best payment terms	9
	Within 2 to 2.99 % of the best payment terms	8
	Within 3 to 3.99 % of the best payment terms	7
	Within 4 %- 4.99 % of the best payment terms	6
	Within 5 %- 5.99 % of the best payment terms	5
	Within 6 %- 7.99 % of the best payment terms	4
	Within 8 %- 9.99 % of the best payment terms	3
	Within 10 %- 11.99 % of the best payment terms	2
	Within 12 %- 12.99 % of the best payment terms	1
	> 13 % of best payment terms	0

Annexure A – Detailed Scoring Criteria and Allocated Points – Contractual Compliance

FINANCIAL EVALUATION: FINANCIAL SUMMARY

	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER 1	2	3	4	5	6	7
[illegible]	REF Contractual Compliance (CC[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

		Y=0.25 N=0	Bidder 1 Unescalated 100 % Co-co	Bidder 2 Escalated 100 % Co-co	Bidder 3 Unescalated 100 % Co-co	Bidder 4 n/a n/a	Bidder 5 Unescalated 100 % Co-co	Bidder 6 Unescalated 100 % Co-co	Bidder 7 Unescalated 100 % Co-co
5.1	General information duly completed (RFP section 3A)		0.25	0.25	0.25	0.25	0.25	0.25	0.25
5.2	Provided AUDITED financial statements for the past 3 years		0	0	0	0	0		0
5.3	Provided AUDITED financial statements for quarters thereafter		0	0	0	0	0	0	0
5.4	Provided latest Rating report from current banker (Fitch or equivalent) & adequacy thereof		0.25	0.25	0	0.25	0.25	0.25	0.25
5.5	Provided strength of approvals (RFP section 3B - c) & adequacy thereof		0.25	0.25	0.25		0.25	0.25	0.25
5.6	Provided a complete breakdown on proposed financing structure on buy option (RFP section 3B - b) & adequacy thereof		0.25	0.25	0.25		0.25	0	0.25
5.7	Provided company equity structure (Holding company and subsidiaries)(RFP section 3B - d) & adequacy thereof		0.25	0.25	0.25		0.25	0.25	0.25
5.8	Provided company debt structure (Holding company and subsidiaries)(RFP section 3B – e) & adequacy thereof		0.25	0.25	0.25		0.25	0.25	0.25
5.9	Provided hedging strategy (RFP section 3B - f) & adequacy thereof		0.25	0	0		0.25	0.25	0.25
5.10	Provided insurance strategy (RFP section 3B - g) & adequacy thereof		0.25	0.25	0.25		0.25	0.25	0.25
5.11	Provided tax strategy (RFP section 3B - h) & adequacy thereof		0.25	0.25	0.25		0.25	0.25	0.25
5.12	Cash flow model adequately provided (RFP section 3 C)		0.25	0.25	0.25		0.25	0.25	0.25
5.13	Provided "Sensitivity Analysis" ratios/proposal		n/a	n/a	n/a	n/a	n/a	n/a	n/a
5.14	Provided Manuals		0.25	0.25	0.25		0.25	0.25	0.25
5.15	Provided Mock Ups		0.25	0.25	0.25		0.25	0.25	0.25
5.16	Provided Maintenance Plan		0.25	0.25	0.25		0.25	0.25	0.25
5.17	Provided Training & Training Manuals		0.25	0.25	0.25		0.25	0.25	0.25
5.18	Provided SD proposal/obligations		0.25	0.25	0.25		0.25		0.25
5.19	Rand based pricing offered		0.25	0.25	0.25		0.25	0.25	0.25
5.20	Fixed pricing excluding escalations offered		0.25	0.25	0.25		0.25	0.25	0.25
5.21	Risk provisions adequately completed (section 2 "clause 13" of RFP)		0.25	0.25	0.25		0.25		0.25
5.22	References adequate		0.25	0.25	0.25		0.25		0.25
5.23	Design life parameters offered adequate (not less than 30 years)		0.25	0.25	0		0.25	0.25	0.25
5.24	Fleet Availability target accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.25	Fleet Reliability target accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.26	Testing & commissioning terms accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.27	Handover & testing terms accepted		0.25	0.25	0		0	0.25	0
5.28	Risk, Title & payment process accepted		0.25	0.25	0		0.25	0.25	0
5.29	Delay & early delivery regime accepted		0.25	0.25	0		0.25	0.25	0.25
5.30	Proposed warranty regime accepted		0.25	0.25	0		0.25	0.25	0.25
5.31	Lawful & safe operation clauses accepted		0.25	0.25	0		0.25	0.25	0.25
5.32	IP clauses accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.33	Contractor covenant clauses accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.34	Spares, change out spares & tools clauses accepted		0.25	0.25	0		0.25	0.25	0.25
5.35	Insurance clauses accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.36	Breach & termination clauses accepted		0	0.25	0		0	0.25	0
5.37	Limitation of liability clauses accepted		0	0.25	0		0	0	0
5.38	Indemnity clauses accepted		0.25	0.25	0		0.25	0.25	0.25
5.39	Force majeur clauses accepted		0.25	0.25	0.25		0.25	0.25	0.25
5.40	Dispute resolution & confidentiality clauses accepted		0.25	0.25	0.25		0.25	0.25	0.25
			8.75	9	6.25	0.5	8.5	8	8.25

Notes

1. Tenderers are evaluated based on their initial response to the tender
2. If there was clarification sent to the tenderer to request any of the above, the tenderer would have failed to comply first time therefore they are rated zero
3. The intention of this evaluation is to credit those tenderers who give TFR a chance for smooth evaluation by proving adequate, requested information right the first time

M M

Annexure A

Detailed Scoring Criteria and Allocated Points

Financial Stability:

FINANCIAL EVALUATION - FINANCIAL SUMMARY										
	WHAT IS BEING MEASURED	WEIGHT	EFFECTIVE WEIGHT	BIDDER						
				1	2	3	4	5	6	7
[illegible]	Financial Stability (15)	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	N/A	[illegible]	N/A	[illegible]

7.1 Total Liabilities/(Total Equity+Total Liabilities)
Gearing Ratio

			1	2	3	4	5	6	7
			ultimate	ultimate	immediate	ultimate	ultimate	ultimate	ultimate
<20%	5								
21% to 30%	4								
31% to 40%	3								
41% to 50%	2								
[illegible]	[illegible]		[illegible]	67.4%				65.6%	
>70%	0		94.7%		83.9%	[illegible]	[illegible]		[illegible]
Score			0	1	0	0	0	1	0

7.2 Capacity

Current Assets vs Current Liabilities

			1	2	3	4	5	6	7
3:1	5								
2.5:1	4								
2:1	3								
[illegible]	[illegible]								
1:1	1		[illegible]	[illegible]		1.03	1.22		[illegible]
< 1:1	0				0.94			[illegible]	
Score			1	1	0	1	1	0	1

7.3 NPAT/Revenue
Profitability
Net profit to turnover

			1	2	3	4	5	6	7
>10%	5								
7 - 9.99%	4								
5% - 6.99%	[illegible]			[illegible]			[illegible]		
[illegible]	[illegible]		[illegible]		4.0%			[illegible]	
1 - 1.99%	1					[illegible]			[illegible]
<1%	0								
Score			2	3	2	1	3	2	1

7.4 Credit ratings of the bidder (Banker issuing guarantee)

			1	2	3	4	5	6	7
[illegible]	[illegible]		5	5	5	5	5	5	5
B rating	4								
C rating	3								
D rating	2								
E rating	1								
F rating	0								
Score			5	5	5	5	5	5	5

Annexure A

Detailed Scoring Criteria and Allocated Points

Financial Stability:

7.5 NPAT/Total Equity
ROE

Greater than 40%	5							
Between 30% & 39.99%	4							
Between 20% & 29.99%	3							
Between 10% & 19.99%	2							
Between 5% & 9.99%	1							
Less than 5%	0							
Score:		5	2	2	2	2	1	1

7.6 EBIT/Total Assets
ROA

Greater than 20%	5							
Between 15% & 19.99%	4							
Between 10% & 14.99%	3							
Between 5% & 9.99%	2							
Between 2% & 4.99%	1							
Less than 2%	0							
Score:		1	2	1	1	2	1	1

7.7 EBIT/Net Finance Charges
INTEREST COVER

> 5 Times	5							
> 4 Times	4							
> 3 Times	3							
> 2 Times	2							
> 1 Times	1							
0	0							
Score		5	5	5	5	5	4	5

7.8
CASH FLOW
Cash generated by operations

Minimum R 200m cash generated from Operations								
Minimum R 400m cash generated from Operations								
Minimum R 200m cash generated from Operations	2				12 852 073 000			
Minimum R 100m cash generated from Operations								
Minimum R 60m cash generated from Operations	1							
< R 50 m as compared to the next bidder	0							
Score:		5	5	5	3	5	5	5
Total score		24.00	24.00	20.00	18.00	23.00	19.00	19.00
Final Score		3.00	3.00	2.50	2.25	2.88	2.38	2.38

Final score would be determined by following formula: (total score /8)*5

NOTES:
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ANNEXURE B

The table below indicates the items that were added or deducted to the base price as submitted by the bidders in order to normalise the price of the locomotive for evaluation purposes.

Option Item	Bidder 1	Bidder 2	Bidder 3	Bidder 5	Bidder 7	Comments
On-Board to Ground Communication System				-		No adjustment, as it is included in the base price of all tenderers and tenderer 5 will include as a free issue.
Fault Information for Maintenance Personnel						No adjustment, as it is included in the base price for all tenderers.
WSP Hardware and Software				91 878		All tenderers included the item in their base price except for tenderer 5, therefore add to the base price of tenderer 5
Remote Access to Control Syst...			2 747			All tenderers included this item in their base price except for tenderer 3, therefore add to the base price of tenderer 3.
Energy Management System	309 300		328 065		427 500	Only tenderer 2 and 5 included the cost in their base price therefore add to the base price of 1, 3 and 7.
Illustrations of Software Algorithms and High level Descriptions of Control Algorithms						All tenderers included this item in their base price therefore no adjustment required.
Redundant Central (Vehicle) Control Unit	17 102		221 142	155 919		Only tenderer 2 and 7 included the cost in their base price therefore add to the base price of 1, 3 and 5.
Supply of 2 Driver Display Units			85 788			All tenderers included this item in their base price except tenderer 3, therefore add to the cost of tenderer 3.
Installation of ECP/WDP and cabling						As per discussion with the technical team (Fredrick Hank), the provisioning of ECP/WDP was a mandatory requirement per the specifications and all tenderers have confirmed in the clause by clause response that they fully complied with this requirement. It was therefore concluded that all tenderers had included the cost of provisioning in their base price and no adjustment is required for evaluations purposes. With regard to the responses to the clarity questions sent out, all tenderers with the exception of CSR, indicated that these items are not part of the base price. It was concluded that these tenderers were referring to the equipment cost and not the provisioning cost. This was based on their responses and the cost provided. Fredrick Hank indicated that the CSR confirmation to the clarity questions refers to the provisioning and not the equipment based on the prices that they quoted. As a result no adjustment to the base price for evaluations purposes was required.
Installation of RDP and cabling						As per discussion with the technical team (Fredrick Hank), the provisioning of ECP/WDP was a mandatory requirement per the specifications and all tenderers have confirmed in the clause by clause response that they fully complied with this requirement. It was therefore concluded that all tenderers had included the cost of provisioning in their base price and no adjustment is required for evaluations purposes. With regard to the responses to the clarity questions sent out, all tenderers with the exception of CSR, indicated that these items are not part of the base price. It was concluded that these tenderers were referring to the equipment cost and not the provisioning cost. This was based on their responses and the cost provided. Fredrick Hank indicated that the CSR confirmation to the clarity questions refers to the provisioning and not the equipment based on the prices that they quoted. As a result no adjustment to the base price for evaluations purposes was required.
Installation of a combination of ECP/WDP and cabling						As per discussion with the technical team (Fredrick Hank), the provisioning of ECP/WDP was a mandatory requirement per the specifications and all tenderers have confirmed in the clause by clause response that they fully complied with this requirement. It was therefore concluded that all tenderers had included the cost of provisioning in their base price and no adjustment is required for evaluations purposes. With regard to the responses to the clarity questions sent out, all tenderers with the exception of CSR, indicated that these items are not part of the base price. It was concluded that these tenderers were referring to the equipment cost and not the provisioning cost. This was based on their responses and the cost provided. Fredrick Hank indicated that the CSR confirmation to the clarity questions refers to the provisioning and not the equipment based on the prices that they quoted. As a result no adjustment to the base price for evaluations purposes was required.
Fire detection system			20 713			All tenderers included the item in their base price except for tenderer 3, therefore add to the cost of tenderer 3.
Supply of the FFCITV on the locomotive	124 639		114 727			All tenderers included the item in their base price except for tenderer 1 and 3, therefore add to the cost of tenderer 1 and 3.
Sim-Train			15 350		15 863	All tenderers included the item in their base price except for tenderer 3 and 7, therefore add to the cost of tenderer 3 and 7.
Anti wheel skid tread brake system			52 033	91 878		All tenderers included the item in their base price except for tenderer 3 and 5, therefore add to the cost of tenderer 3 and 5.
Transformer Short circuit test	2 051			2 009	4 705	All tenderers included the item in their base price except for tenderer 1, 5 and 7, therefore add to the cost of tenderers 1, 5 and 7.
Transformer Dogs			157 364			All tenderers included the item in their base price except for tenderer 3, therefore add to the cost of tenderer 3.
Ablution requirements			82 423			All tenderers included this item in their base price except for tenderer 3, therefore add to the cost of tenderer 3.
Wheels			-118 447			Tenderer 3 included a more expensive option, therefore we reduced their price by the difference in cost between our requirement and their proposed option.
Roof Equipment Design			181 164			All tenderers included the item in their base price except for tenderer 3, therefore add to the cost of tenderer 3.
MU functions with Diesel locomotives	65 100		194 595			All tenderers included this item in their base price except for tenderers 1 and 3, therefore add to the cost of tenderers 1 and 3.
Additional tests on Traction motors	5 259					All tenderers included the item in their base price except for tenderer 1, therefore add to the cost of tenderer 1.
Main Transformer Basic Insulation Level			53 431		364 137	All tenderers included the item in their base price except for tenderers 3 and 7, therefore add to the cost of tenderers 3 and 7
Center Dogs			270			All tenderers included this item in their base price except for tenderer 3, therefore add to the cost of tenderer 3.
Equipment cost of WDP/ECP combination and RDP in a ratio of 340:259 over the fleet of 379 locos	742 548	1 262 187	1 848 657	1 012 258	1 310 344	As per the technical team, this option will probably be executed. On the 2nd Dec 2013, JD provided the split which we used to calculate the unit price per loco for this option
Total adjustment to base price	1 366 001	1 262 187	3 185 748	1 303 041	2 122 548	

Workings					
	R				
Cost of WDP/ECP equipment	366 850	654 039	746 200	448 010	593 000
Cost of RDP equipment	332 000	958 806	1 453 891	621 167	973 750
Cost of WDP/ECP and RDP combination	687 700	1 500 800	2 149 378	1 310 177	1 566 750
Equipment cost of WDP/ECP and RDP combination and RDP only in a ratio of 340:259 over the fleet of 379 locos	742 548	1 262 187	1 848 657	1 012 258	1 310 344

As per the technical team, this option will probably be executed. On the 2nd Dec 2013, JD provided the split which we used to calculate the unit price per loco for this option

Annexure C

The table below indicates the standard delivery schedule used for the payment terms evaluation.

	2014	2015	2016	2017	2018
April	5	10	10	10	12
May	5	10	10	10	12
June	5	11	11	11	12
July	5	11	11	11	12
August	5	11	11	11	12
September	5	11	11	11	12
October	5	11	11	11	12
November	6	11	11	11	12
December	6	11	11	11	12
January	6	11	11	11	12
February	6	11	11	11	12
March	6	11	11	11	12
Total locos delivered per year	65	130	130	130	144
Cumulative total locos delivered	65	195	325	455	599

Annexure D

Summary and analysis of payment terms results

Deposit amount

The RFP and the clarity responses to the RFP stipulated the deposit amount to be R 300 million for batch 1 (65 locomotives).

Bidder 5 indicated based on their clarity response received that the R 300m upfront deposit is applicable for the full fleet of 599 locomotives.

Bidder 1 did not specify the R 300 million deposit amount as an initial upfront payment and provided deposit percentages according to their own requirements (refer to payment terms summary).

The other 3 bidders indicated that the R 300 m deposit upfront is applicable for batch 1 only (which is what was required based on the RFP and the clarity responses to the RFP).

The upfront deposit percentage (1.62%) is applicable for all bidders except Bidder 1 and is computed based on the R 300 m deposit divided by the contract price (standard price).

At face value it would appear that the impact on NPV would be the same for all bidders who stipulated the 'R 300 m deposit amount', however the allocation of the upfront deposit for the full fleet of 599 locomotives as opposed to the first batch of 65 locomotives changes the cash flow configuration when the locomotives are accepted.

Where the R 300m paid is spread over the entire fleet the amount payable for each acceptance of locomotives will be equal over the full fleet. Whereas, if the R 300m paid is spread over the first batch, the remaining amount payable for each acceptance of locomotives will be significantly lower for year 1, thereby impacting positively on the NPV.

Deposit amount Batch1 v Fleet Deposit per loco:

Batch	Deposit amount	No of locomotives	Deposit amount per loco
First	R 300 000 000	65	R 4 615 385
Full fleet	R 300 000 000	599	R 500 835
Difference			R 4 114 550

Difference in cash flow for loco acceptance in year 1 R 267 445 742.90

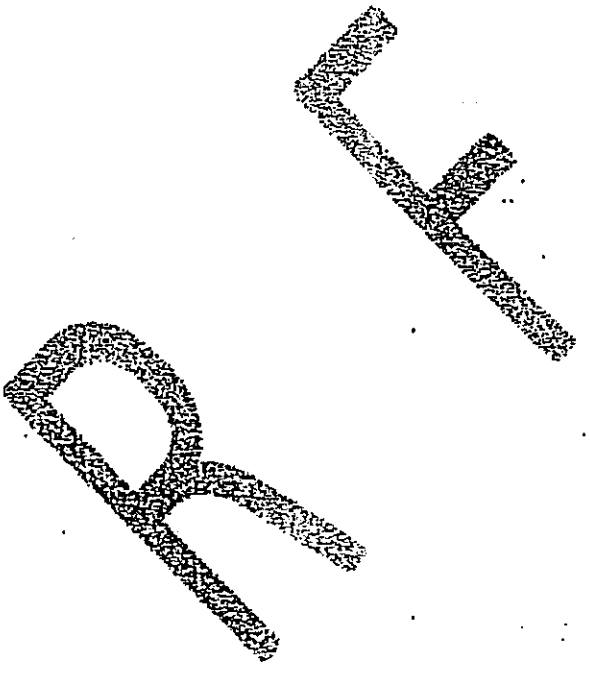
Therefore TFR would pay this additional portion above in year 1 with the resulting effect equalising over the period of 599 delivery.

The differential is therefore a discounting impact for year 1 (higher NPV for TFR) compared to the payment of the differential over the 559 period.

Accordingly although bidder 5 and bidder 7 have the same percentage payment terms bidder 5 would have a higher NPV due to the impact of the deposit of R 300m being relevant for the entire fleet compared to bidder 7 whose R 300m deposit is payable for batch 1 only.

Bidder 1 and Bidder 3 have the highest NPV's which is reflective of their payment terms. These bidders have requested significantly high deposit amounts (Bidder 1 -24% and Bidder 3 -24.62%).

Based on the scoring criteria set these bidders are significantly penalised (Bidder 1 - 0 points and Bidder 3 - 1 point).



Annexure E

Reconciliation of price

The following table provides a reconciliation between the submitted bid prices to the final evaluated prices, highlighting the impact of each change to the final price used for evaluation:

	Bidder 1	Bidder 2	Bidder 3	Bidder 5	Bidder 7
Price per boo as submitted by bidder	30 955 000	34 380 000	39 906 949	31 358 000	29 880 000
Add: Additional items to balance back to annexure F	1 821 465	636 007	1 165 646	698 720	809 401
Special tooling	3 762	34 789	39 997	136 998	37 000
Engineering support					
Capital Spares	491 240	402 918	855 648	538 547	507 538
Consumables	45 302		7 817		
Spares holding	27 405	198 300	253 334	8 150	264 762
Setup cost			8 799	15 025	
Insurance					
Rounding			51		1
Forex Hedging	1 253 756				
Price per boo submitted as per annex F (capital acquisition cost)	32 776 465	35 016 007	41 072 595	32 056 720	30 689 309
Adjustments to normalise:					
Deduct Schedule B capital spares	-16 360	-122 648	-19 114	-	-23 946
Deduct Forex hedging	-1 253 756	-	-	-	
Sub Total 1 (Price excluding impact of hedging and escalations)	31 506 349	34 893 359	41 053 481	32 056 720	30 665 403
Add Options.	1 266 001	1 262 187	3 165 748	1 303 041	2 122 546
Sub Total 2 (Price with Options included)	32 772 350	36 155 546	44 219 229	33 359 761	32 787 949
Impact of Re-basing (foreign exchange movements)	1 966 587	2 040 643	2 082 677	4 731 994	907 051
Sub Total 3 (Total price before TE adjustment)	34 738 937	38 196 188	46 301 906	38 091 755	33 695 000
Impact of not using TE as the main sub-contractor	-1 905 514	-3 480 000	-	-	-
Price used for evaluation	32 833 423	34 716 188	46 301 906	38 091 755	33 695 000