LEADERSHIP PERSPECTIVE

The measures of our success as a State-owned Company are varied, and intricately linked to our ability to create inclusive and sustained value for the national economy. We continue to drive growth through the expansion and modernisation of the country's ports, rail and pipelines infrastructure, having invested R145 billion over the past five years; and we contribute to the quality of life for all South Africans by proactively enabling the broader development goals of the Government's National Development Plan (NDP). The NDP has its roots in the United Nations' Sustainable Development Goals and aligns with the integrated developmental aspirations of the African Union's Agenda 2063. Accordingly, we see ourselves as part of an African and indeed globally inclusive community with a planetary mandate to ensure sustainable social and economic progress worldwide.

Our success is also defined by the value we create for the economies of several other African states that use South Africa's networks and harbours to transfer their imports and exports to inland markets. Beyond moving goods from ports across land on rail, much of our future success will depend on our ability to harness South Africa's strategic location, infrastructure and skills base to accelerate growth in the new maritime economy with our ports serving as strategic conduits of trade on the southern-most tip of Africa. We are ideally positioned to serve the East-West cargo traffic and the booming African offshore oil and gas industry, through marine manufacturing, which includes ship and rig repair, refurbishment and boatbuilding. The oceans have the potential to contribute up to R177 billion to the gross domestic product (GDP) and create just over one million jobs by 2033[1].

The recently unveiled **TransAfrica Locomotive** is a brainchild of our engineering and manufacturing Division, Transnet Engineering. It was **conceptualised** and **engineered** by a team of experts from within Transnet and assembled at our production facility in Koedoespoort, east of Pretoria, with **60% of its components being locally manufactured**.

We are, as a country and an organisation, part of a vast global family, and we are growing ever closer through digital communication platforms and shrinking our physical borders to harness the infinite opportunities of the 'cloud'[2].

What does this mean for Transnet going forward? Whereas we have historically based both our commercial success and the success of our Sustainable Developmental Outcomes squarely on the inherent value created by Transnet's infrastructure expansion and logistics activities, we now need to acknowledge the exciting – yet daunting – prospects inherent in the fast-emerging digital paradigm of the 4th Industrial Revolution[3]. As Transnet, we require resilience, agility and adaptive capacity to transition successfully over the coming decades.

On a continent still widely challenged by social inequalities, food insecurity and persistent job losses, a transition to a futuristic digital paradigm seems remote. However, this will be exactly the fertile soil from which emerging technologies, entrepreneurial ideas and tenacious digital innovations will grow and thrive, leapfrogging the growing pains experienced by developed economies through technological advancements. Regionally networked transport infrastructure too will play a critical part. The recently unveiled TransAfrica Locomotive[4] is a brainchild of our engineering and manufacturing division, Transnet Engineering. It was conceptualised and engineered by a team of experts from within Transnet and assembled at our production facility in Koedoespoort, east of Pretoria, with 60% of its components being locally manufactured.

Transnet intends to thrive in this new paradigm. To be successful, we must both simplify and ramp up our current operations to meet the one consistent feature of this new landscape – unprecedented change. We must also ensure that our performance targets reflect the current economic perspective and market realities; and that our governance capability is fit for purpose to both enable and protect the future value we create, particularly as we diversify revenue streams, adapt to emerging industry trends and technologies, and identify new market opportunities, mainly beyond regional borders and through intra-Africa logistics partnerships.

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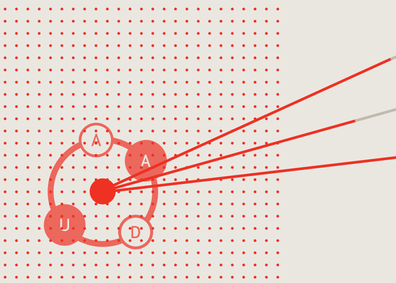
1 *https://www.environment.gov.za/projectsprogrammes/operationphakisa/oceanseconomy.*

2 *Where in the past, people would run applications or programs from software downloaded on a physical computer or server in their building, cloud computing allows people to access the same kinds of applications through the internet. [http://mashable.com/2013/08/26/what-is-the-cloud/#7imW03iPzgqr].*

3 *The 4th Industrial Revolution, or '4IR,' is the fourth major industrial era since the initial Industrial Revolution of the 18th century. The 4IR can represent a range of new technologies that are fusing the physical, digital and biological worlds, and impacting all disciplines, economies and industries. It can be compared to the Second Machine Age in terms of the effects of digitisation and AI on the economy, but with a broader role for advancing biological technologies. Central to this revolution are emerging technology breakthroughs in fields such as artificial intelligence, robotics, the Internet of Things, autonomous vehicles, 3D printing, quantum computing and nanotechnology. [https://en.wikipedia.org/wiki/Fourth_Industrial_Revolution].*

4 *Unveiled in April 2017, the TransAfrica Locomotive is suitable for use on branch lines and in the yard for shunting, while also being able to travel on old rail tracks originally designed to carry light axle loads. The diesel-powered TransAfrica Locomotive is appropriate for aged railway lines that operate on the Cape Gauge system, offering a cost-effective solution for the majority of the continent's railway lines that are currently unused.*

38 Moving into the sixth year of the Market Demand Strategy (MDS), we have so far invested R145 billion in key projects in the freight system across the rail, port and pipeline networks. The key driver behind the large MDS capital investment programme remains the need to close the gap between the market demand for cargo transport and handling services, and the infrastructural capacity to satisfy this demand. We expect to invest a further R229,2 billion over the remaining MDS period, which will include an amount of R20 billion set aside expressly for harnessing validated opportunities to diversify revenue streams, so as to accelerate and facilitate growth over the MDS period to 2024.



1 Linda Mabaso
2 Siyabonga Gama
3 Garry Pita

Over the past five years we have observed the market decline, and we have responded by setting future growth projections for key commodity customers on a lower growth path, requiring a slower pace of capacity creation from Transnet. The continued lower-than-planned demand for freight logistics services directly impacts Transnet's revenue line and, as a result, impacts the affordability of our capital investments. Notwithstanding ongoing economic uncertainty, lower demand and depressed commodity prices, our performance for the year confirmed 80 Transnet's financial agility and operational endurance. Revenue for the year increased by 5,3% to R65,5 billion (2016: R62,2 billion), driven by a 4,9% increase in general freight and a 2,4% increase in export coal railed volumes. The respective increases were due to market-share growth arising from a shift in rail-addressable cargo from road to rail, and improved operational efficiencies from the deployment of new-generation locomotives on the network. Container volumes increased marginally by 0,7%, while manganese volumes increased by an impressive 17,5% to 12,1 mt (2016: 10,3 mt). This exceptional volume performance was mainly due to the recovery in commodity prices in this sector, which resulted in customers increasing production outputs. We, in turn, responded by improving operational efficiencies – 63 most notably through the Transnet Value Chain Coordinator, a strategic initiative intended to drive volumes in line with MDS commitments by addressing operational integration, customer satisfaction and operational efficiency, thereby optimising our utilisation of assets and our ability to deliver targeted returns on our investment.

We continued to mitigate the impact of slow economic growth through stringent cost-containment measures and working-capital management, containing operating costs at R37,9 billion (2016: R35,9 billion), a 5,6% increase. This resulted in a R2,4 billion saving in planned costs. As a result, earnings before interest, taxation, depreciation and amortisation (EBITDA) – Transnet's key measure of profitability – increased by 5,0% to R27,6 billion (2016: R26,3 billion). The EBITDA margin decreased by 0,2% to 42,1% (2016: 42,2%).

We maintained financial stability and agility by optimising capital expenditure based on validated demand, with our capital investment for the year amounting to R21,4 billion (excluding capitalised borrowing costs), representing a 27,5% decrease from the prior year (2015: R29,6 billion). The capital investment for the year represents R5,2 billion invested in the expansion of infrastructure and equipment, while R16,2 billion was invested in maintaining capacity in the rail and ports divisions.

Our rail network continues to face strong competition from road transport, and has lost significant tonnages to road over the past two decades. It is imperative, therefore, that we expand our rail development framework to meet region-wide rail service capacity, while at the same time growing tonnages and capturing market share. Our road-to-rail initiatives remain at the forefront of Freight Rail's strategy, and the market has shown huge interest in this area of the Freight Rail value offering, particularly as it relates to the automotive industry.

Additionally, Africa's intra-continental trade has almost doubled since 1995, and the increase in volume of goods moving through the supply chain is creating transportation and logistical complexities SR that slow down shipments. Transnet, in collaboration with General Electric, plans to deliver a 'smart port' digital solution that will 52 enhance efficiency and productivity in the regional transport sector by connecting shippers and transport operators and simplifying intricate commercial issues, such as pricing, capacity on the network, and making it easier to plan shipments to get goods to market. On average, Transnet delivers 13 000 containers and 620 000 tons of goods critical to Africa's economy daily.

Freight Rail's regional business impetus is to grow cross-border volumes and to enable regional integration of rail, with particular focus on the Maputo Corridor[5], the East/West Corridor[6] and the North/South Corridor[7]. We have established joint operating centres in Mozambique, Botswana and Zimbabwe to promote alignment between the rail companies that occupy these corridors so that rail operators can execute one unified railway system per corridor.

As economic growth in Africa unfolds, the demand for rolling stock and associated maintenance will increase. Engineering already operates in this space and is well positioned to meet increased demand. The development of the TransAfrica Locomotive will satisfy a market need at a competitive price. Going forward, Engineering will pursue Original Equipment Manufacturer (OEM) status in passenger trains. This requires intensive investment to remain critical in developing research and business intelligence to increase revenue in niche markets. Transnet's ability to attract sufficient funding remains key to our ability to greatly expand our commercial horizons, regionally and indeed globally.

The basis of Transnet's geographic expansion for the ports sector lies in port concessions, which remain lucrative in the region, while significant future regional opportunities for our Pipelines business pertain to the discovery of new oil and gas reserves in Africa, which has resulted in a significant demand for new infrastructure capacity and new-build project opportunities.

We envisage driving our regional business activities through a wholly owned subsidiary, Transnet International Holdings, which has been approved by the Transnet Board of Directors, the Department of Public Enterprises (DPE) and the Minister of Finance. Transnet International Holdings will be operational in 2018. Our total Africa revenue for the 2017 financial year amounted to R2,1 billion.

As a transportation and logistics company, Transnet's information and communication technology capability must evolve beyond business enablement to become a competitive edge. We are already embracing innovative digital technology to create business value, such as 3D printing for rolling stock, electronic enclosure design 30 and certain mechanical sub-components. Aerial and underwater 92 drones, as well as track and trace technology, will soon become familiar features of our operational landscape. Through our newly established 'think tanks' – internal hubs where some of our best minds are collaborating to innovate Transnet's product and service solutions – we hope to stretch digital innovations even further, both for our own usage and also as potential future revenue streams.

The longer-term vision for Transnet is encapsulated in our new strategic framework, Transnet 4.0, as introduced in our Integrated 47 Report. The framework sets the scene for our future commercial activities and will, importantly, guide our activities for the remaining MDS period while establishing a firm foundation for our activities post-MDS.

Our 2017 Integrated Report is focused on the future, and we are encouraged by the growing enthusiasm in the Company in terms of 48 what a digital future might mean for the 'Transnet of tomorrow' – from the perspective of enhanced operational efficiencies and new revenue streams; and also what it could mean for more sustainability-conscious operational impacts on the environment.

We need to return briefly to the year in review to appreciate the collective efforts of our employees during a difficult economic period. Overall, our operational efficiency ratio exceeded the 2017 target by 14,9%. We have also started to reshape the core of our business to create an optimally streamlined and agile operational 17 structure, with the commercial, technical and marketing expertise to deliver on our short- to medium-term MDS commitments, and to gear us up for the long term. Due to the need to optimise and right size the employee base across the business, this included the difficult decision to offer voluntary severance packages to employees. However, we acknowledge that this restructure effort put strain on our people, particularly with the spectre of a credit rating downgrade looming.

At the time of writing this report, international rating agency, Standard & Poor's has lowered the Company's foreign currency rating to BB+ from BBB- and the local currency to BBB- from BBB, both with a negative outlook. On 13 June 2017, Moody's also

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[5] *South Africa, Swaziland, Mozambique.*

[6] *South Africa, Namibia, Botswana, Lesotho.*

[7] *South Africa, Zimbabwe, Zambia, Democratic Republic of Congo, Tanzania.*

lowered the Company's rating to Baa3 with a negative outlook. Both these actions were due to the rating action on the Sovereign as Transnet is viewed to be closely linked to the Government. We have evaluated the potential impact on the Company's financial position, liquidity and solvency and do not expect significant negative effect on estimates. S&P's affirmation and acknowledgement of the critical role that Transnet plays in South Africa's economy as a provider of essential infrastructure services evidences the strong and agile manner in which Transnet management is navigating present macroeconomic challenges. S&P has further indicated that Transnet's liquidity was still adequate and has acknowledged the sound relationship it has with South African banks. The agency also recognised the Company's good standing in capital markets, its sufficient risk and management framework, and its unused credit facilities.

The year included several sad events within our operations, with 15 employees passing away. On behalf of the Board of Directors, we wish to express our heartfelt condolences to their families and friends. We have no words to describe the overwhelming sense of loss felt by all within Transnet who were touched by the passing of one or more colleagues. We also lost our fellow Board member and close friend, Peter Williams, who passed away on 15 March 2017. He enriched the Transnet Board with his authoritative views on ethical leadership and governance. We miss Peter; and we are grateful for his dedicated service over the past three years.

We further wish to convey our sympathies to the families of the 82 members of the public who lost their lives during the year in and around our operational activities. We are determined to do better by reviewing the nature and causality of all fatalities and by ensuring that we continue to entrench Group-wide safety awareness. Thank you to our colleagues at executive and management levels who have taken up the baton of safety and are actively driving this awareness through roadshows, operational site visits and safety campaigns, both internally and with communities who live close to our railway lines and other infrastructure.

In transitioning into the digital world of the 4th Industrial Revolution, we need to adjust our ambitions in the short term while looking for more sustainable longer-term solutions. Competition is tough, the economy is uncertain, but we must reinvent ourselves to build the 'Transnet of tomorrow.' A collective future needs to be imagined collectively. This requires a common vision and single-minded determination to get us there.

Appreciation

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We wish to thank each of our 58 828 colleagues who continue to contribute to our financial and organisational longevity. We appreciate your dedication and commitment during a difficult year and encourage you to reimagine your own contribution to the 'Transnet of tomorrow.'

We also wish to thank the leadership of our recognised unions, South African Transport and Allied Workers Union (Satawu) and United National Transport Union (UNTU), for their guidance, leadership and willingness to share in the Company's long-term vision.

Thank you to our colleagues on the Board of Directors for your wisdom and wise counsel. Your continued support is invaluable.

Thank you to our customers and commercial partners for your continued support and confidence in our abilities amid difficult economic and operational conditions during the year. We look forward to improving our service in the year ahead and finding common solutions to our shared challenges.

Our sincere gratitude to the Minister of Public Enterprises, Ms Lynne Brown – who represents our Shareholder and the people of South Africa – for her unflagging efforts in ensuring we meet our mandate. The Shareholder Minister and her officials' contribution to our success is invaluable.

Our deep appreciation to our regulators, including ministries with which we work closely; as well as various committees in Parliament; provincial governments; and municipalities that contribute their oversight responsibilities and partnership commitments.

To community partners across the country, it is a privilege to collaborate with you in our various enabling projects.

Lastly, thank you to all our colleagues across Transnet who participated in our 2017 integrated reporting process.

LC Mabaso

LC Mabaso
Chairperson

S.I. Gama

SI Gama
Group Chief Executive

PITA

GJ Pita
Chief Financial Officer

1 June 2017
Johannesburg