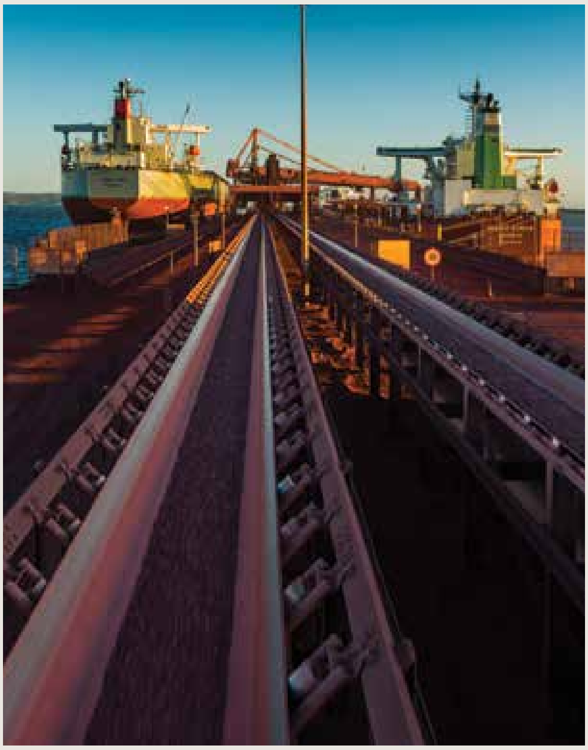
OUTLOOK

Global growth for the year was characterised by sluggish recovery and has remained at 3,1% – the same as the prior year. South Africa registered negligible growth due to the effects of weak global demand, low commodity prices, a severe drought and low levels of business and consumer confidence. With a GDP growth rate of 0,7%, which is marginally below the expected growth rate of 0,8%, and unemployment rising to the highest level in 13 years, South Africa also saw a contraction in private-sector capital investment. A challenging outlook for the country going forward was further affirmed by the downgrade of the Sovereign credit rating by two credit rating agencies to so-called junk status, from 'BBB' to 'BB+' -' and the long-term local currency rating to 'BBB-' from 'BBB'.

Globally, a high degree of uncertainty dominates geopolitical and economic relations. Tensions in many parts of the globe are rising, and populist movements have appeared in Europe and the United States. Political tensions have now made advanced economies a major locus of policy uncertainty, with rhetoric in many countries suggesting an orientation towards inward-looking policies and protectionism. On the upside, concerns from a year ago regarding China's growth prospects and the consequent struggles of primary commodity exporters have largely abated, with commodity prices partially recovering.



The expectation is for moderate global economic recovery in 2017. World growth is expected to rise from 3,1% in 2016 to 3,5% in 2017, and 3,6% in 2018[1].

Despite the commodity price recovery, commodity prices are expected to remain below their peaks in 2011 to 2014 peaks, reflecting a weak global recovery[2]. Prospects for 2017 differ sharply across countries and regions, with emerging Asia in general, and India in particular, showing robust growth. Sub-Saharan Africa is forecast to experience overall growth of only 2,6%.

GDP growth %

	Actual		Projections	
	2015	2016	2017	2018
World GDP	3,1	3,1	3,5	3,6
Sub-Saharan Africa	3,4	1,4	2,6	3,5
USA	2,4	1,6	2,3	2,5
EU	1,6	1,7	1,7	1,6
Brazil	(3,8)	(3,6)	0,2	1,7
Russia	(3,7)	(0,2)	1,4	1,4
India	7,3	6,8	7,2	7,7
China	6,9	6,7	6,6	6,2
South Africa	1,3	0,7	0,8	1,6

The short-term global outlook is mixed and, with it, Transnet's demand picture is also mixed. We continue to experience slow global recovery and uncertainty, paired with an increasingly challenging economic environment at home. Our strategic intent as an SOC, encapsulated in the Statement of Strategic Intent from our Shareholder (DPE), requires us not only to navigate these precarious economic times in a manner that improves our bottom line, and secures our future, but also to chart a course that leads the country towards sustainable and inclusive growth. As a large infrastructure company, we intend to contribute towards this growth by investing in strategic infrastructure ahead of demand, of which the positive outcomes extend to both our commercial and developmental objectives. However, it is crucial that we temper our aspirations for capacity creation in the context of current market conditions. We are, therefore, repositioning the MDS, now in its sixth year, to increase capacity ahead of pre-empted, 'validated' demand.

In the prior year's scenario planning, we revised our seven-year capital portfolio planning down from initial projections of R277,8 billion to R254,9 billion if economic recovery remained stagnant. Transnet now expects to invest R229,2 billion over the next seven years to 2024, thereby reducing our capital investment planning by R48,6 billion.

[1] *International Monetary Fund, 2017. World Economic Outlook: Gaining Momentum? Washington, April*

[2] *Africa Pulse, October 2016, Volume 14, https://openknowledge.worldbank.org/handle/10986/25097*

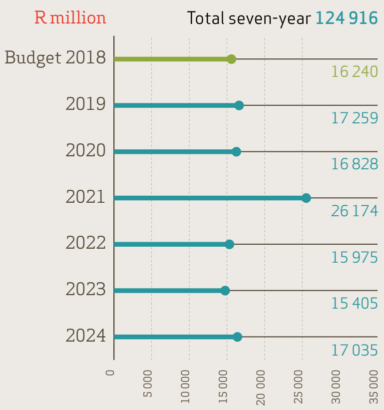
As a result of the Sovereign rating downgrade by S&P Global, the ratings agency has reviewed Transnet's long-term foreign currency Sovereign credit rating from 'BBB-' to 'BB+', and the long-term local currency rating from 'BBB' to 'BBB-'. This outlook is in line with the rating agency's assessment of the Sovereign rating given that Transnet's rating is linked to that of the Sovereign. S&P has, however, maintained Transnet's standalone credit profile at 'BBB', reflecting our strong financial metrics as we execute our multi-billion-Rand infrastructure investment programme.

Transnet is indeed well positioned to withstand the downgrade, as we continue to raise funds on the strength of our own balance sheet. Transnet does not receive funding or guarantees from the National Government. We will continue to undertake our investment and capitalisation strategies with the requisite degree of prudence and risk awareness to ensure we do not undermine our financial sustainability.

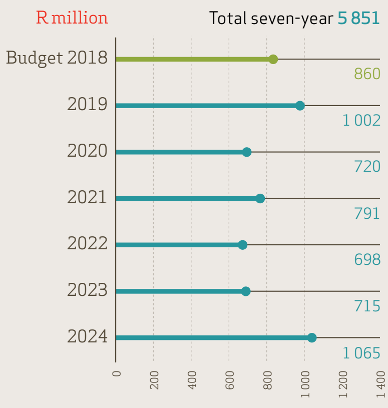
Capacity creation

Transnet aims to achieve capital spend of R229,2 billion over the Market Demand Strategy (MDS) period (between R340 billion and R380 billion to be invested over the next 10 years) to increase capacity across all commodities and sectors.

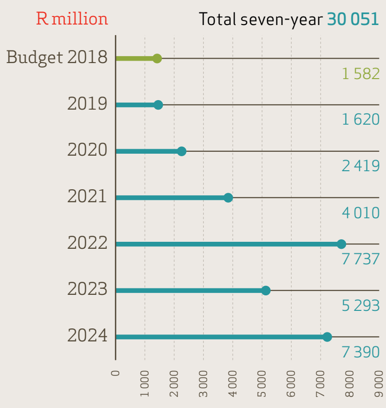
Freight Rail



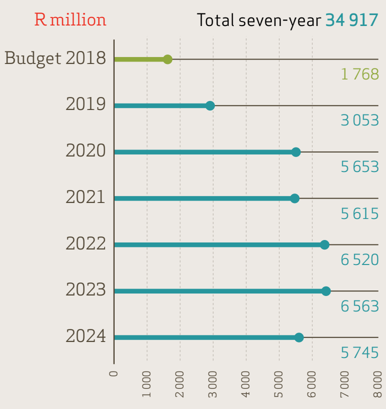
Engineering



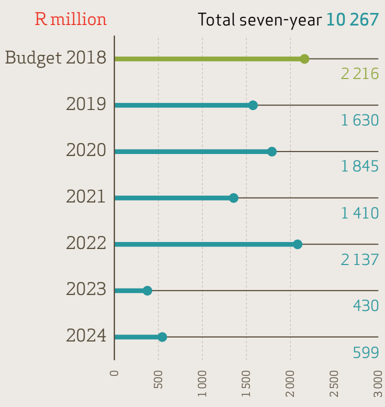
Port Terminals



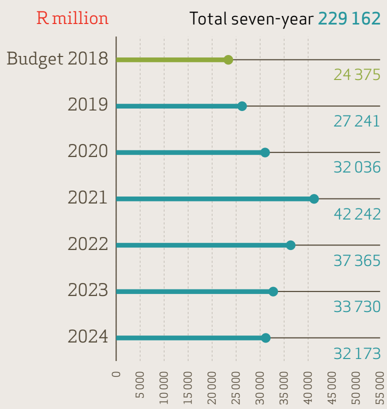
National Ports Authority



Pipelines



Total capacity creation



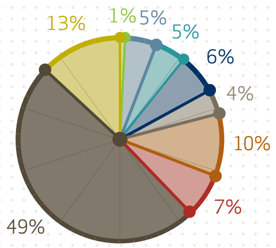
Short- to medium-term focus

Going forward, we will continue to develop opportunities in the port, rail and pipeline sectors, supporting Transnet's geographic expansion revenue driver: creating a footprint for the Company beyond the borders of South Africa.

Our Capacity Creation Programme focuses on five core strategic areas, with projects and programmes grouped together based on the business outcomes. These five mega-programmes constitute 85% of the portfolio:

1. Coal and mineral system
2. General freight business and rolling stock
3. Manganese
4. Ports
5. Pipelines

Seven-year capital investment by commodity (%)



- 1% Break-bulk R1,9 billion
- 5% Piped products R10,3 billion
- 5% Bulk other R9,9 billion
- 6% Manganese R12,5 billion
- 4% Iron ore R8,9 billion
- 10% Maritime containers R21,5 billion
- 7% Coal R14,3 billion
- 49% General freight R102,4 billion
- 13% Automotive and other R27,5 billion

** Excluding R20 billion allocated to Mergers and Acquisitions.*

Coal and mineral system

Transnet has embarked on a programme to sustain and create rail infrastructure capacity to unlock the Waterberg and Mpumalanga coal reserves for Eskom power stations, domestic industrial users and export markets. In addition, various other mineral developments are being pursued in Limpopo for domestic and export purposes.

The Waterberg region has 40% of South Africa's remaining coal reserves and is regarded as the next strategic growth node of the coal sector. The availability of infrastructure is critical to unlock the region's potential and is a prerequisite for current and future mining developments. The investment will secure rail transport capacity from Waterberg for the export market and for domestic (Eskom) consumption. This project will be rolled out in a phased approach to align with validated demand.

General freight business and rolling stock

In the rail sector, the General Freight business presents the greatest opportunity for growth, with potential volumes increasing to 137,0 mtpa by 2024. Present market challenges have compelled Freight Rail to review the delivery of planned MDS rolling stock in line with the reduced capacity required. All rolling stock requirements are being prioritised for the areas where the much-needed capacity is required and not affected by the changes in market conditions. Although locomotive shortages have historically been the main bottleneck to grow general freight volumes, the delivery of new locomotives must be adjusted in line with reduced business requirements. This still allows Transnet to retire the current aged fleet of locomotives (some exceeding 40 years), resulting in a reduction in locomotive capitalised maintenance.

The New Build Wagon Programme has not been left unscathed by market conditions. The need for efficient delivery of the New Build Wagon Programme, combined with the economic downturn, means that Freight Rail has a higher wagon capacity than volume demand. Going forward, Transnet has the opportunity to enhance efficiencies and increase wagon utilisation in line with Gold Class Railways internationally.

Freight Rail will continue to seek volume growth by serving existing and new customers, particularly in as much as Transnet's regional strategy opens up new market prospects. As growth in Africa unfolds, the need for a modal shift in freight transportation from road to rail will become more urgent and the demand for new or refurbished rolling stock, together with associated maintenance services, will continue to increase. Engineering is already operating in this space and is well positioned to take advantage of the increased demand. It has extensive manufacturing facilities and the capacity of these facilities is easily increased through the introduction of additional shifts.

Manganese

South Africa holds more than 80% of the world's medium- to high-grade manganese ore reserves, making it a sustainable, lucrative supply market to Europe and China. Transnet is fully committed to developing a new, expanded manganese bulk ore terminal in the Port of Ngqura, fulfilling its promise to terminate operations at the current manganese bulk terminal in Port Elizabeth due to environmental challenges.

Ports sector

Container strategy

The demand trends and the goal for container trade is to maintain an efficient intermodal supply chain. The National Ports Authority has developed a strategy for port infrastructure development for container handling. South African ports currently handle a throughput of 4,5 million TEUs. Container movement through the east coast (Durban) comprises 65% of total container volume, which makes the east coast the leading region for container flows. The majority of these containers are utilised within the Durban, Pinetown and Cato Ridge area. Over the next 10 years, demand along the Durban–Gauteng corridor is expected to grow from 3,0 million to 4,2 million TEUs. Vessel technology is also forecast to change over the next 10 years, which will place demand on the ports for longer quays, deeper berths and channels, larger outreach equipment, higher efficiencies and state-of-the-art operations.

Break-bulk strategy

There is sufficient break-bulk capacity in most ports and, as a result, both Cape Town and Durban will convert break-bulk berths to cater for alternative commodities based on validated demand. In the ports of Ngqura, Mossel Bay and Saldanha Bay, break-bulk berths are planned for commercial reasons as these ports are strategically placed to harness oil, gas and other potential energy-related industries, and to support the fishing industry.

Dry bulk strategy

Dry bulk development is heavily export driven, with 82% of the total volume being made up of coal, iron ore and manganese. The balance comprises ferrous metals, magnetite and chrome.

Port of Durban

The Port of Durban is South Africa's premier multi-cargo port and is counted among the busiest ports in Africa, handling over 80 mtpa of cargo. This is the leading port in the Southern African Development Community region and the premier trade gateway for South-South trade, Far East trade, Europe and the United States, East and West Africa regional trade. It is the international commercial gateway to South Africa and is strategically positioned on world shipping routes. The Port of Durban occupies a focal point in the transport and logistics chain with 60% of all imports and exports passing through the port. It therefore assumes a leading role in facilitating economic growth in South Africa. The main capacity focus for the port is ensuring safe berths and the protection of current and future revenue streams and the construction of berths that will cater for long-term future-generation vessels together with the flexibility to accommodate future changes in types of cargo handled in this port, including deep-water container handling.

Pipelines

The discovery of new oil and gas reserves in Africa has resulted in a significant demand for new refining, storage, pipeline and marine terminal infrastructure capacity, which translates into a broad list of new-build project opportunities. However, oil and gas commodity prices remain low and in some instances below project hurdle rates, and are placing a damper on new-build infrastructure development plans.

It is envisaged that numerous new-build opportunities will progress to final investment decision in 2018 and 2019, and will be issued to the private sector on a Build, Operate and Transfer concession. These projects signal a strong political desire to drive oil revenues and provide frontier economies an opportunity to enter the global oil and gas sector. Transnet is well placed to participate in such concessions given the sound operational and recent new-build experience that resides within Pipelines and Group Capital. This experience and the depressed development activity in this sector offers Transnet an opportunity to focus on developing strategies, partnerships and relationships with prospective developers. Pipelines is working closely with Freight Rail to offer an integrated pipeline and rail solution as an alternative to volumes presently being transported by road. This model can be replicated to service neighbouring countries such as Botswana and Zimbabwe.

Transnet has identified Ghana, Nigeria, Ethiopia, Djibouti, Kenya, Mozambique, Botswana and Tanzania as prospective markets.

In addition to geographic expansion, Pipelines will embark on a service offering development strategy to broaden its current service offering in oil and gas to a full supply-chain offering from ship to refinery/storage depot to field depots; and full supply-chain service offerings for liquefied petroleum gas and liquefied natural gas.

Conclusion

To safeguard capital value created in the short to medium term, we must adapt to changing market conditions in an agile way to protect important ratios until growth returns in earnest. Current market conditions continue to temper Transnet's expectations while strengthening the Company's resolve regarding its strategy. The MDS has been tailored to respond to market dynamics through employee dynamism, financial agility, operational unity and perpetual innovation. In implementing the MDS, the Company will focus on volumes, safety and capital optimisation in the new year and take advantage of available growth opportunities to ensure that the overall objectives of the MDS are ultimately achieved.

Key initiatives for the year ahead

Financial sustainability	Capacity creation	Market segment competitiveness	Operational excellence
Freight Rail			
• Accelerate new business development and back to rail initiatives to improve volume performance. • Improve operational efficiencies and consistency. • Improve diversified revenue opportunities.	• Implement approved capital programmes to sustain and/create capacity – Coal 81 mt expansion, Overvaal Tunnel doubling, manganese expansion and New 1 064 Locomotive Programme. • Refine and implement Wagon Build Programme to meet customer demand. • Commission and deploy new locomotives – 22E, 23E and 44D – according to the deployment plan.	• Develop and implement marketing strategies, pricing and contracting models to grow identified customers in the General Freight business segments. • Continue to develop bi-modal technologies. • Continue rollout of digital applications.	• Embed 2020 programmes for improved productivity, utilisation and efficiencies. • Implement programmes for continuous improvement in cost effectiveness, waste reduction, volume growth and efficiency improvement. • Pursue efficiencies across operating channels.
Engineering			
• Pursue growth from external customers, mostly in the locomotive build programme, as well as growth in Africa market share. • Review and enhance cost-optimisation and reduction initiatives. • Revenue diversification.	• Expand Engineering's footprint in the rest of Africa by setting up maintenance workshops in targeted countries. • Provide remote technical/field service support to customers as part of warranty maintenance services.	• Develop the next versions of the TransAfrica Locomotives and passenger coach transportation (MC-25). • Develop the next version of the Train Control and Monitoring System (TCMS).	• Rollout advanced traction motor designs. • Establish world-class motor test facilities. • Rollout capability-enhancement initiatives for motor development. • Introduce flexible design strategies.
Port Terminals			
• Enhance operations and supply-chain efficiency to unlock capacity in the bulk sectors. • Promote additional export channels for manganese. • Optimise service delivery within the Durban Container precinct.	• Increase capacity for the Saldanha MPT terminal from 8,7 mtpa to 10 mtpa through mobile ship loaders. • Deploy a dedicated bulk export terminal at Ngqura to create capacity to handle 16 mtpa of manganese. • Expand capacity in the automotive sector.	• Containers: Unlock capacity and improve operational efficiencies. • Bulk: Integrated contract management. • Break-bulk: Channel optimisation through TVCC to improve efficiencies. • Automotive: Expand operations at the East London Car Terminal.	• Maximise crane deployment across vessels. • Collaborate with shipping lines to optimise stowage. • Express-loading empty containers through twin and tandem lift operations. • Effective yard planning to minimise delays caused by re-handling of containers in the stack.
National Ports Authority			
• Market the South African port system through local industry platforms and customer forums, global industry platforms and conferences, seminars and other promotion mediums (sector-based promotion, i.e. containers, automotive, Operation Phakisa products).	• Invest R1,7 billion (2017/18) and R34,9 billion (seven year: 2017/18 to 2023/24) in capacity creation, infrastructure renewal and modernisation projects.	• Various initiatives to improve customer services and market performance. • Implement port operational performance standards. • Continue the rollout of operational centres, and deploy smart technology.	• Improve availability of marine service fleet through the fleet management programme. • Continue quarterly assessments of the performance of Terminal Operators against Terminal Operator Performance Standards (TOPS).
Pipelines			
• Engage Nersa regarding NMPP prudency. • Pursue a new business focus relating to gas and terminal operations.	• Achieve multi-product operation of the NMPP trunkline through tightlining and the completion of the Inland Accumulation Facility by 30 November 2017. • Commence the FEL1 for the replacement of the Sasolburg to Kroonstad pipeline and the Jameson Park to OR Tambo Airport pipeline.	• Achieve the set petroleum volume target of 17,6 billion litres. • Increase volumes at Tarlton, including influencing Botswana supply mix. • Review compatibility of other gases with methane-rich gas (MRG) to facilitate new entrants into the pipeline.	• Successful conversion of the NMPP to handle multi-products and management of intermixture generation on completion of the tightlining solution and the Inland Accumulation Facility.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