TRANSNET

Transnet Pipelines 2021

Contents

Highlights

Revenue decreased by **14,6%** to **R4,9 billion**

EBITDA is reported as a loss of **R2,05 billion**

Achieved a DIFR of **0** against a target of **0,6**

Business overview

Transnet Pipelines (Pipelines) is the largest multi-product pipeline operator in southern Africa, with more than 55 years' experience of operating and maintaining a 3 114 km high-pressure petroleum and gas pipeline network in South Africa. The core strategic mandate of Pipelines is to ensure petroleum security of supply for the inland market and gas security of supply for the KwaZulu-Natal market through the Lilly Pipeline using environmentally responsible methods while ensuring optimal efficiencies. Pipelines is strategically positioned to enable regional integration from pipeline to other modes of transport. Pipelines is regulated by the National Energy Regulator of South Africa (Nersa).

To this effect, Pipelines currently transports:

- More than 70% of all refined products to the inland market;
- More than 70% of all jet fuel required at OR Tambo International Airport;
- 100% of the crude requirements for the National Petroleum Refiners of South Africa (Natref);
- 500 million m^3 of methane-rich gas requirements annually to KwaZulu-Natal from Secunda; and
- 100% of Tarlton Distribution Terminal volumes, of which 35% are distributed over-border.

The initiative to secure a direct import terminal in the Port of Durban and a terminal operating licence has become a key strategic objective for Pipelines, in alignment with the Transnet Liquid Fuels Master Plan to enable:

- New market participants in line with the Liquid Fuels Charter expectations, which emphasises the promotion of broad-based black economic empowerment and overall sector transformation;
- Clean fuels envisaged by the Department of Mineral Resources and Energy, which necessitates increased import terminal capacity due to the inability of local refineries to produce clean fuels in the medium to long term; and
- The expected increase of fuel imports as per recent developments regarding future plans of local refineries, which will be enabled and facilitated by the existing capacity on the 24" multi-product pipeline (MPP).

The 24" MPP trunk line is in full operation with a current capacity of 148 Mℓ per week. The line is capable of transporting two diesel grades (D10 and D50) and two unleaded petrol grades (93 and 95) as well as jet fuel. The inland accumulation facility located in the strategic node of Jameson Park, Gauteng (TM2) with a capacity of 180 Mℓ facilitates security of supply to the inland economic hub and surrounding areas.

The decommissioning of the Durban to Johannesburg Pipeline (DJP) is in progress. Based on the outcomes of the current studies, the DJP servitude from Durban to Kroonstad will be retained for potential future utilisation.

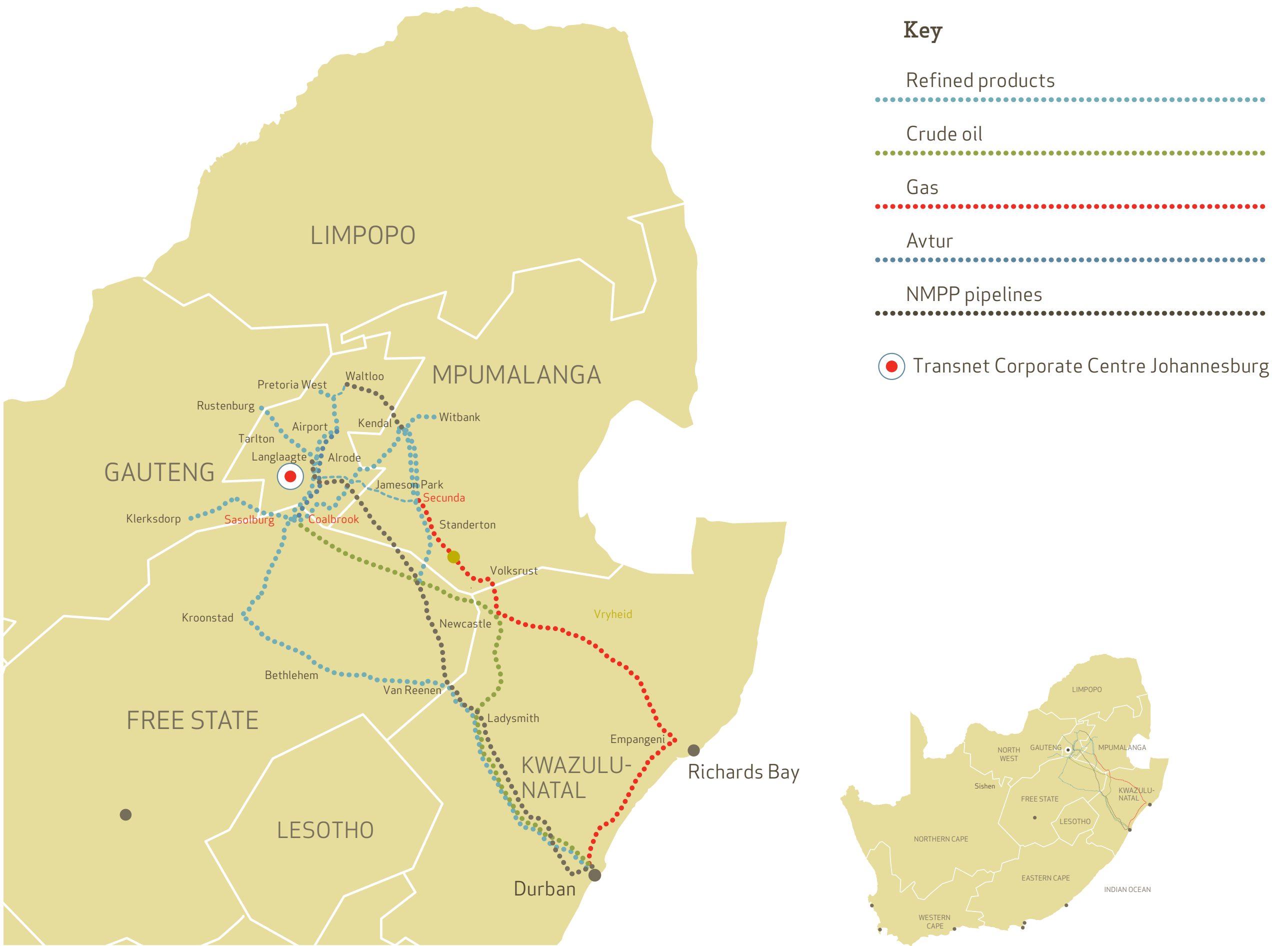
A seamless integrated rail and pipeline service offering to customers is currently in operation to OR Tambo International Airport to ensure jet fuel security of supply. It is envisaged that a similar supply chain solution can be provided to other domestic airports in the near future.

Pipelines is ideally positioned as an enabler in delivering the Transnet Natural Gas Network Strategy, which is aligned to the country's energy demand in conjunction with other relevant state-owned entities and stakeholders. This will be achieved by utilising the existing infrastructure as a base to grow the natural gas supply chain logistics network.

Where we operate

Pipelines' footprint spans across five provinces with 11 delivery stations for liquid petroleum that are strategically positioned to deliver the mandate of security of supply.

Figure 1: Pipelines' geographic locations



Regulatory environment

Pipelines is a licensed gas, liquid petroleum and petroleum storage business regulated by Nersa, which regulates the energy industry in accordance with government laws and policies, standards and international best practices. To this end, almost all critical areas of Pipelines' business require regulatory sanctions through the issuing of licences. Compliance with licence conditions is critical to Pipelines continuing as a going concern. Therefore, regulatory certainty and sustainability factors are of primary significance to the mandate of Pipelines.

As the custodian of South Africa's strategic pipeline assets, Pipelines is governed by the National Energy Regulator Act, No 40 of 2004, Petroleum Pipelines Act, No 60 of 2003 and the Gas Act, No 48 of 2001. To ensure continued business operations, Pipelines has a duty to comply with the conditions of the following licences as issued by Nersa:

- Licence to operate a petroleum pipeline system
- Storage
- Gas transmission
- Construction (MPP and related infrastructure)

Operational performance

Core initiatives for 2021

- Achieve the volume targets for the financial year
- Mitigate impact of fuel theft incidents on operational and financial performance
- Increase safety awareness to reduce safety incidents
- Strengthen Pipelines' Safety, Health, Environment, Risk and Quality Strategy to ensure compliance with safety regulations
- Implement the Transnet Integrated Management System (TIMS)

Overview of key performance indicators

Key performance area and indicator	Unit of measure	2019 Actual	2020 Actual	2021 Target	**2021 Actual**	2022 Target
Financial sustainability						
Revenue	R million	5 262	5 731	5 892	**4 892**	4 986
EBITDA	R million	4 174	3 811	4 629	**(2 052)**	3 569
Return on invested capital	%	n/a	5,7	7,7	**(8,5)**	5,6
EBITDA margin	%	79,3	66,5	78,6	**(41,9)**	71,6
Operating profit margin	%	54,9	44,1	56,8	**(68,4)**	45,4
Gearing	%	31,1	23,1	15,6	**21,2**	0,1
Net debt to EBITDA	times	2,4	1,9	1,1	**(2,6)**	0,6
Return on average total assets	%	7,5	6,5	8,5	**(8,6)**	5,9
Asset turnover – excluding CWIP	times	0,1	0,1	0,1	**0,1**	0,1
Cash interest cover	times	3,3	5,3	7,4	**6,3**	8,8
Capacity creation and maintenance						
Capital investment	R million	326	412	814	**499**	891
Actual vs planned maintenance	%	n/a	n/a	n/a	**n/a**	90
Production interruptions	hours	332	312	438	**290**	438
Operational performance						
Volume and revenue growth						
Total petroleum	Mℓ	17 825	17 764	17 657	**13 067**	15 850
Refined	Mℓ	11 186	11 196	11 652	**9 003**	10 302
Crude	Mℓ	5 462	5 440	4 910	**3 679**	4 510
Avtur	Mℓ	1 177	1 128	1 094	**385**	1 038
Gas	million m^3	511	511	515	**493**	520
Storage	Mℓ	597	634	366	**321**	583
Capacity utilisation (actual usage: capacity)						
DJP and NMPP	Mℓ/week	110:148	106:148	110:148	**81:148**	95:148
Crude	Mℓ/week	105:134	104:134	87:134	**71:134**	87:134
Avtur	Mℓ/week	1	22:24	20:24	**8:24**	20:24
Electricity efficiency	Mℓ.km/MWh (year-on-year percentage improvement)	n/a	n/a	n/a	**n/a**	n/a
Operating cost per Mℓ.m (a)	R/Mℓ.km	139	227	174	**1 233**	215
Gas (actual usage: capacity)	million m^3/month	43:57	43:57	42:57	**41:57**	43:57
Service delivery						
‘Off spec’ volumes	litres per billion delivered	2 043 187	–	216 952	**–**	206 105
Number ‘off spec’ delivery events per thousand dockets	number	0,34	–	0,30	**–**	0,30
Ordered vs delivered volume	%	97,0	97,5	95,0	**99,0**	95,00
Planned vs actual delivery time	%	91,0	88,9	90,0	**83,2**	91,00
Sustainable development outcomes						
Employment (human capital)						
Training spend	% of personnel cost	2,90	2,70	2,50	**1,50**	3,80
Employee turnover	%	5,17	5,15	5,00	**5,25**	5,00
Employment equity	% of black employees	89,58	90,96	90,00	**91,75**	90,00
Absenteeism index	%	1,78	2,10	2,50	**1,18**	2,50
Employee headcount	number	672	675	709	**679**	713
Female employees	% of headcount	34,07	34,37	35,00	**36,67**	35,00
People with disabilities	% of headcount	2,08	2,07	3,00	**2,20**	3,00
Risk, safety and health						
DIFR	rate	0,18	0,70	0,60	**0,00**	0,75

Financial performance review

Salient features		Year ended 31 March 2021 R million	Year ended 31 March 2020 R million	% change
Revenue		**4 892**	5 731	(14,6)
– Refined		**2 898**	3 160	(8,3)
– Aviation fuel		**26**	66	(60,7)
– Crude		**1 757**	2 278	(22,9)
– Gas		**121**	114	5,4
– Handling		**31**	54	(41,9)
– Other		**7**	6	9,4
– Clawback and levy		**53**	53	0,0
Operating expenses		**6 944**	1 921	261,5
– Energy costs		**237**	322	(26,5)
– Maintenance		**161**	129	24,8
– Materials		**43**	5	850,1
– Personnel costs		**468**	473	(1,0)
– Other		**6 035**	992	508,3
Profit from operations before depreciation, derecognition, amortisation and items listed below (EBITDA)		**(2 052)**	3 811	(153,9)
Depreciation, derecognition and amortisation		**1 294**	1 282	0,9
Profit from operations before items listed below		**(3 346)**	2 529	(232,3)
Impairments and fair value adjustments		**93**	2	(>100)
Net finance costs		**527**	908	42,0
Profit before taxation		**(3 966)**	1 618	(345)
Total assets (excluding CWIP)		**38 120**	39 244	(2,9)
Profitability measures				
EBITDA margin[1]	%	**(41,95)**	66,49	(108,4)
Operating margin[2]	%	**(68,39)**	44,12	(112,5)
Return on total average assets (excluding CWIP)[3]	%	**(8,65)**	6,46	(15,11)
Asset turnover (excluding CWIP)[4]	times	**0,13**	0,15	(13,7)
Capital investments[5]	R million	**499**	412	21,1
Employees				
Permanent employees	number	**679**	675	0,6
Revenue per employee	R million	**7,20**	8,49	(15,1)

1 *EBITDA expressed as a percentage of revenue.*

2 *Profit from operations before impairment of assets, fair value adjustments, net finance costs and taxation expressed as a percentage of revenue.*

3 *Profit from operations before impairment of assets, fair value adjustments, net finance costs and taxation expressed as a percentage of total average assets excluding capital work in progress.*

4 *Revenue divided by total average assets excluding capital work in progress.*

5 *Actual capital expenditure (replacement + expansion) excluding borrowing costs and including capitalised finance leases.*

Performance commentary

Financial sustainability

- Revenue for the year decreased by 14,6% to R4,9 billion (2020: R5,7 billion) mainly due to the decline in petroleum volumes transported for the year.
- Net operating expenses increased by 261,5% to R6,9 billion (2020: R1,9 billion). This significant increase is predominantly due to:
  - An increase in environmental remediation and rehabilitation costs of approximately R890 million; most of these costs relate to provisions raised for future remediation and rehabilitation;
  - A R307 million increase in the decommissioning provision based on the reassessment of the provision in line with the current approved activities for decommissioning; and
  - An amount of R4,04 billion relating to provisions for litigious claims against the organisation.
- Consequently, EBITDA for the year is a R2,05 billion loss (2020: R3,81 billion profit).

Looking ahead

- Pipelines with Nersa will finalise the MPP prudency review.
- Owing to the continued product theft incidents there is potentially a significant environmental cost impact on the 2022 financial year.
- Pipelines will continue with the Total and Sasol litigation resolution.

Capacity creation and maintenance

- Pipelines' R499 million spend for the year is lower than the target of R819 million.
- The capital expenditure for the year has been negatively impacted by the COVID-19 lockdown and its consequent effect on construction and procurement-related activities.

Looking ahead

The focus for the 2022 financial year is to establish a Project Management Office at Pipelines and develop project management expertise. This will support the following initiatives:

- Achieve capital expenditure of R891 million.
- Commence feasibility studies on projects to grow Pipelines in line with the Transnet Strategy.
- Accelerate the implementation of projects to mitigate the impact of fuel theft incidents.

Operational performance

Volumes

- The petroleum volumes for the year of 13,07 billion litres is 26,0% lower than the budget of 17,66 billion litres and 26,4% lower than the previous year 17,76 billion litres. This was a result of the country being on COVID-19 lockdown for the first few months in the financial year and the subsequent slow economic recovery following the lockdown. The product theft incidents are also impacting volume performance, with a number of lines being shut down for repairs following 'hot taps', during March 2021. Pipelines is observing a gradual increase in volumes compared to the start of the lockdown.

Capacity utilisation

- The MPP capacity utilisation of 81 Mℓ per week is below the target of 110 Mℓ per week (2020: 106 Mℓ per week) due to a combination of the following:
  - The impact of the COVID-19 lockdown and the ongoing negative effect on the economy which resulted in low demand;
  - Interruptions caused by the product theft incidents on the MPP;
  - Product shortages at the coast as the result of ship delays; and
  - The shutdown of the Engen Refinery following the explosion and fire.
- Gas volumes are 3,5% lower than prior year due to lower demand from customers as a result of the depressed economic environment.
- Tarlton Storage YTD volume is 12,3% lower than the target due to product supply challenges from the coast and theft incidents which have negatively affected loading from Tarlton.

Service delivery

- The ordered versus delivered volumes was 98,9% versus the target of 95%. The measure also improved from the prior year achievement of 97,5%.
- The planned versus the actual delivery times was 83,2% versus the budget of 90% mainly due to the product theft incidents.
- Pipelines' operational cost per mega litre kilometre (Mℓ.km) of R1 233 Mℓ.km is higher than the target of R174 Mℓ.km due to the environmental provision of R1 395 million and the R4,04 billion litigious claims against the organisation.

Looking ahead

- The focus will be to implement the Pipeline Security Strategy to ensure safe operations and minimise the impact of fuel theft on operational and financial performances.
- Pipelines will fast-track the environmental remediation backlog to comply with relevant and applicable environmental legislation while maintaining organisational sustainability.

Sustainable development outcomes

Human capital (employment and transformation)

- Pipelines achieved a permanent employee headcount of 679 (target: 709).
- Black employees represented 91,75% (2020: 90,96%) of the total employee base against a target of 90%.
- Female employees represented 36,67% (2020: 34,37%) of the total employee base against a target of 35%.
- People with disabilities represented 2,2% (2020: 2.07%) of the total employee base against a target of 3%.
- The employee turnover rate is 5,25% (2020: 5,15%) compared to a target of 5%.
- The absenteeism index of 1,18% (2020: 2,1%) is lower than the target of 2,5%.

Skills development

- Pipelines achieved a training spend of 1,5% compared to a target of 2,5%.

Health and safety

- The DIFR rate of 0 was achieved for the year compared to a target of 0,60.

Quality assurance

- Pipelines has been recommended for TIMS certification, an integrated management system based on ISO 9001, ISO 14001 and ISO 4500.

Environmental stewardship

- Pipelines' focus in the 2021 financial year was to address the impact of fuel theft on the environment.
- The unprecedented number of incidents during the 2020 financial year resulted in significant environmental contamination based on the resultant spillage of product in the areas where the thefts occurred. Pipelines has a legal obligation in terms of section 30 of the National Environmental Management Act, 107 of 1998 to take all reasonable measures to contain and minimise the effects of the incident to reduce the risk to human health and the environment and to remedy the immediate and long-term effects of the incident on the environment and public health.

Key risks and mitigating activities

The top six risks below were identified during the year under review with appropriate mitigating plans.

Key risks	Mitigating activities
Material payout in terms of the Natref neutrality principle	• An appeal is to be lodged with the Constitutional Court
Reputational and brand risk	• Regular customer engagements • Process in place to address issues with impacted land owners due to theft of fuel • Timeous responses to media queries
Ineffective contract management	• Address the issue of resource constraints • Training to address the issue of skills
Regulatory uncertainty	• Compliance control plans in place • Ongoing training and awareness • Continuous engagement with the regulator and monitoring of licence conditions
Loss of volumes	• Initiatives to increase volumes • Integrated security strategy to address the product theft incidents
Negative financial impact of Nersa prudency review	• Awaiting response from Nersa on the outcome of its review

Opportunities

- Utilise the existing infrastructure as a base to grow the natural gas supply chain logistics network.
- Collaborate with other state-owned companies and the private sector to develop mechanisms for new players to access the pipeline network to improve capacity utilisation and overall sector transformation by facilitating collaboration with key oil and petroleum stakeholders.
- Offer a seamless integrated rail and pipeline service offering to other domestic airports in the near future to grow the Avtur business.
- Fast-track the execution of a capital investments plan to support the fuel and gas segment strategies.
- Promote pipeline capabilities to attract new business and grow the business inside and outside of South Africa.

Abbreviations and acronyms

CWIP	Capital work in progress
DIFR	Disabling injury frequency rate
DJP	Durban to Johannesburg Pipeline
Mℓ	million litres
MPP	Multi-product pipeline
Natref	National Petroleum Refiners of South Africa
Nersa	National Energy Regulator of South Africa
TIMS	Transnet Integrated Management System