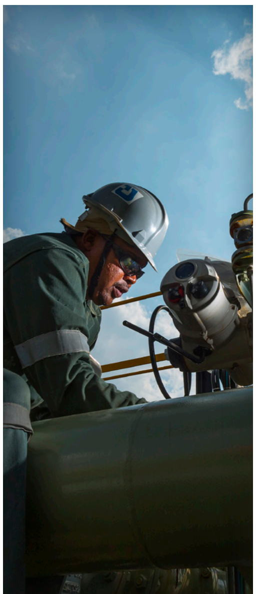
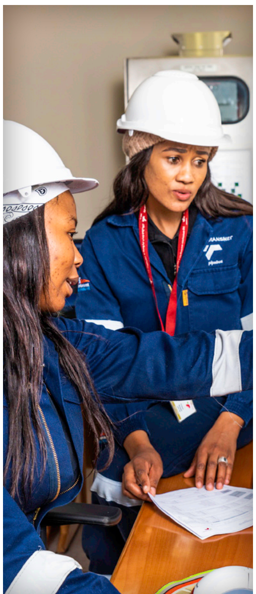
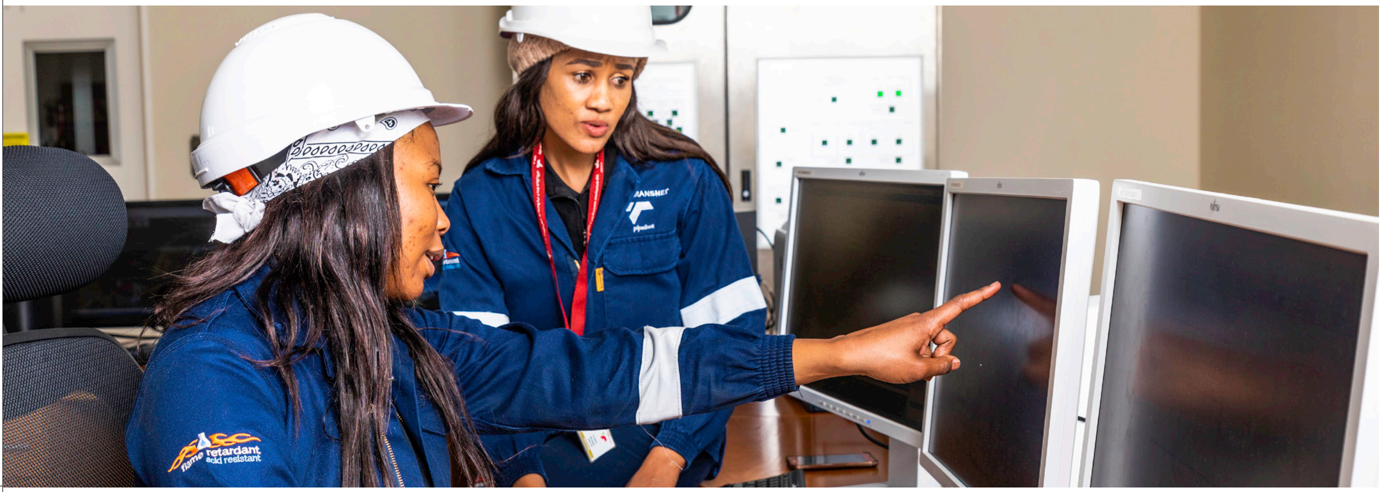



TRANSNET PIPELINES 2020




Contents



Highlights

Revenue increased by **8,9%** to **R5,7 billion**.

EBITDA decreased by **4,7%** to **R3,8 billion**.

Petroleum volumes transported decreased by **0,3%** to **17,8 billion** litres.

Recorded a DIFR of 0,70 against a target of **0,60**.

Business overview

Transnet Pipelines (Pipelines) is the largest multi-product pipeline operator in southern Africa, transporting liquid petroleum and methane-rich gas through a network of 3 116 kilometres of pipeline infrastructure. The core strategic objective of Pipelines is to play a key role to ensure the product security of supply for the inland market. Pipelines offers integrated pipeline network supply chain solutions while ensuring the best safety practices and optimum service reliability, and exceeding customer expectations at all times through capable human capital.

To this effect, Pipelines currently transports:

- More than 70% of all refined products required for the inland market;
- More than 70% of all jet fuel required at OR Tambo International Airport;
- 100% of crude requirements for the Natref refinery;
- 100% of pipeline methane-rich gas requirements to KwaZulu-Natal from Secunda; and
- 100% of Tarlton Distribution Terminal volumes of which 35% is distributed over-border.

The initiative to secure a direct import terminal in the Port of Durban and secure a terminal operating licence has become one of the key strategic objectives 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 places emphasis on the promotion of broad-based black economic empowerment and overall sector transformation; and
- The Clean Fuels II Programme as envisaged by the Department of Energy, which necessitates increased import terminal capacity due to the changes in fuel specification in the medium to long term.

The New Multi-Product Pipeline (NMPP), 24-inch trunk line is in full operation with a 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, has been operational since December 2017. It facilitates security of supply to the inland economic hub and surrounding areas.

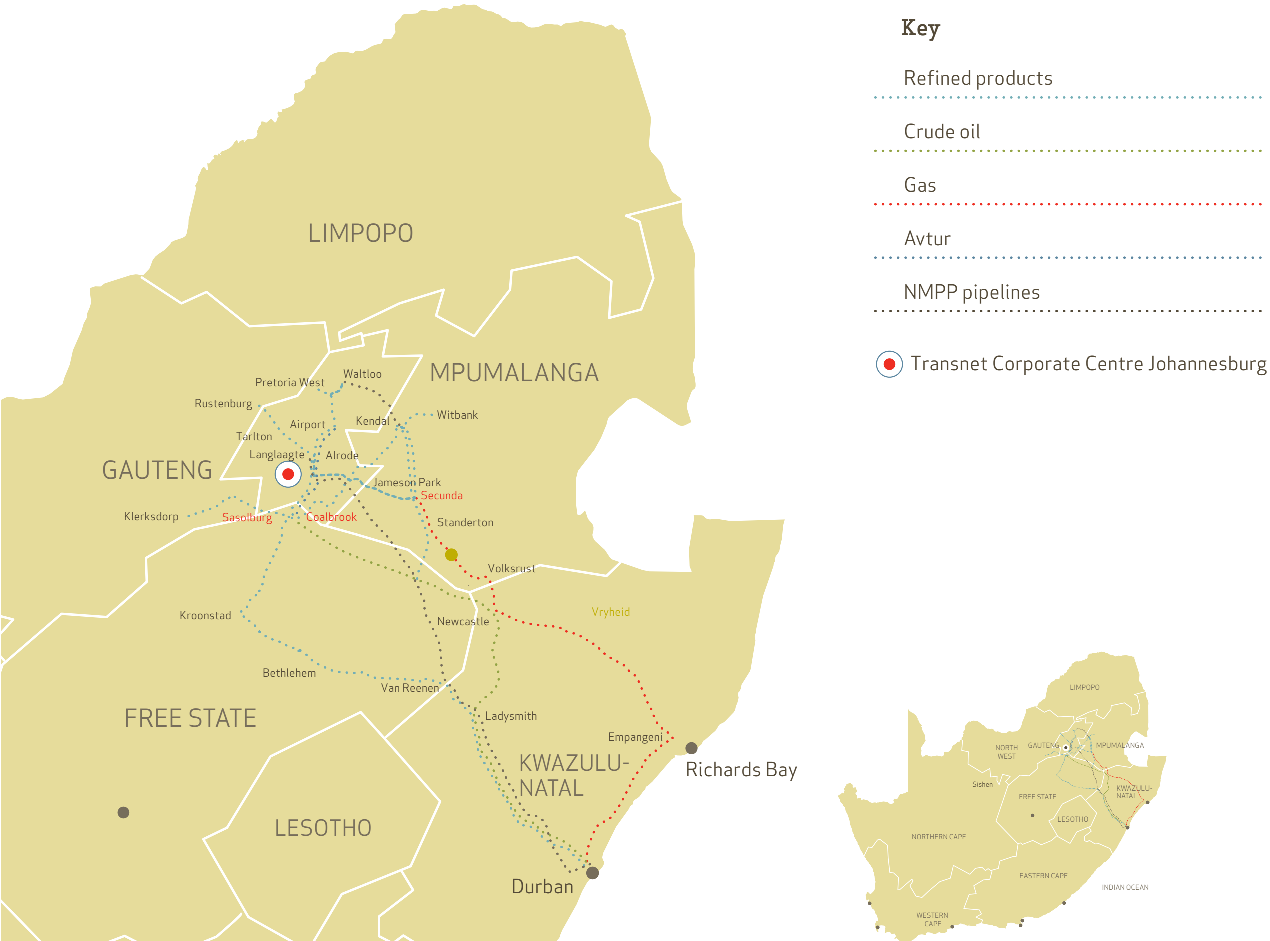
The decommissioning of the Durban to Johannesburg Pipeline (DJP) is currently in execution and is expected to be completed in 2021. The alternative uses for the asset, including associated infrastructure, are currently under consideration. It is envisaged that, subject to the demand validation and viability, the portion of the DJP between Durban and Pietermaritzburg can be repurposed to supply gas to the greater Pietermaritzburg industrial areas.

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. Pipelines envisages providing an optimised pipeline solution to Cape Town International Airport in the near future.

Transnet's International Strategy is driven by Transnet International Holdings (TIH) to grow beyond the borders of South Africa. Pipelines is working in conjunction with TIH to reposition the division to be a liquid and gas terminal and pipeline operator of choice across the African continent, therefore this is crucial to Pipelines' growth aspirations. Opportunities to diversify into the liquefied natural gas (LNG) market are also being pursued in South Africa.

Where we operate

Figure 1: Pipelines' geographic locations



Regulatory environment

Pipelines is a gas, petroleum pipeline and petroleum storage business regulated by the National Energy Regulator of South Africa (Nersa). Almost all critical areas of the business require regulatory sanctions through the issuing of licences. The maintenance of the licensing status quo is core to Pipelines continuing as a going concern.

As the custodian of South Africa's strategic pipeline assets, Pipelines is governed by the Petroleum Pipelines Act, No 60 of 2003. 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 (NMPP and related infrastructure)

Principle 13 of the King IV Code on Corporate Governance states that the governing body, Pipelines, should govern compliance with applicable laws and adopt non-binding rules, codes and standards in a way that supports the organisation being ethical and a good corporate citizen.

In the event where Pipelines' primary regulator, Nersa, suspends, revokes or imposes additional and onerous licensing conditions to the existing licences, this may have an adverse implication on the division's business, which may, inter alia, include business closure, revenue loss, negative reputational implications including vicarious and personal liability.

The safety, health and environmental (SHE) issues remain critical from a regulatory perspective. This is evident from the myriad of legislative requirements that can be enforced from a SHE perspective. Compliance with enforcement directives from various Government departments and other regulatory agencies is also vital. These departments and agencies include, among others, the Department of Labour, the Department of Energy, the Department of Environmental, Forestry and Fisheries, the Department of Health, the Competition Commission and the Railway Safety Regulator, which is responsible for overseeing safety in the railway transport industry.

Transnet, which manages the single Railway Safety Regulator permit, annually renews the Company's permit to operate the rail siding in Tarlton for over-border deliveries.

An amendment application to the NMPP Project Construction Licence has been submitted to Nersa to reflect the following envisaged completion dates:

- Complete construction of TM1 tanks and accumulation facilities – 30 June 2023
- Complete construction of Sapref R-Tanks – 31 March 2021

The expected output in terms of enforcement directives is that, where a duty to comply arises, Pipelines must ensure that it complies with such directive(s). Compliance best practice requires that Pipelines reviews its regulatory universe annually in order to remain relevant in the changing regulatory environment. For the purpose of this plan, the following legislation is interpreted as having strategic impact on the way that the division performs its functions. The relevant legislation, impacts and mitigations are set out in the table below:

Regulation	Impact	Mitigation	Extent of compliance
Petroleum Pipelines Act (PPA)	• Significant fines and withdrawal of operating/transmission licence	• Continued compliance with licence conditions including improved regulator engagements	• Compliance status has matured, however, Pipelines continuously reviews the PPA Compliance Control Plan (CCP)
Gas Act	• Significant fines and withdrawal of operating/transmission licence	• Continued compliance with licence conditions including improved regulator engagements	• Compliance status has matured, however, Pipelines continuously reviews the Gas Act CCP
National Environmental Management Act (NEMA)	• Increase in operational costs while waiting for processing of environmental approvals, e.g. water-use licences to enable Pipelines to legally discharge water	• Build stakeholder relationships to ensure the impact on the business is understood and that authorisations and/or licences are issued timeously	• Compliance status has matured, however, Pipelines continuously reviews the NEMA CCP
Occupational Health and Safety Act (OHSA)	• Poor workplace safety leads to significant worker accidents and interruptions in operations	• Ensure compliance with the Act and its applicable regulations	• Compliance status has matured, however, Pipelines continuously reviews the OHSA CCP

Operational performance

Core initiatives for 2020

- Minimise the impact of the 2020 petroleum tariff determination on EBITDA and other key financial ratios
- Achieve the volume targets for the financial year
- Continued execution of the following major projects:
  - Construction of the Sapref replacement tanks
  - FEL3 validation of the TM1 accumulator tanks
  - Upgrade the Fire Protection System at its various sites
  - Control system development and crude deployment
- Improve operational efficiencies for the financial year

Overview of key performance indicators

Key performance area and indicator	Unit of measure	2017/18 Actual	2018/19 Actual	2019/20 Target	**2019/20 Actual**	2020/21 Target
Financial sustainability						
Revenue	R million	4 488	5 262	6 725	**5 732**	5 892
EBITDA	R million	3 192	3 996	5 430	**3 810**	4 629
Return on invested capital	%	n/a	n/a	9,2	**5,7**	7,7
EBITDA margin	%	71,5	75,94	80,7	**66,47**	78,6
Operating profit margin	%	48,3	54,9	62,3	**44,1**	56,8
Gearing	%	38,3	31,1	23,4	**23,1**	15,6
Net debt to EBITDA	times	3,9	2,4	1,4	**1,9**	1,1
Return on total average assets	%	7,0	7,5	10,8	**6,5**	7,7
Asset turnover – excluding CWIP	times	0,1	0,1	0,2	**0,1**	0,1
Cash interest cover	times	2,7	3,3	5,8	**5,3**	7,4
Capacity creation and maintenance						
Capital investment	R million	1 544	326	1 418	**412**	814
Actual vs planned maintenance	%	n/a	n/a	n/a	**n/a**	n/a
Production interruptions	hours	371	332	438	**312**	438
Operational performance						
Volume and revenue growth						
Total petroleum	Mℓ	16 345	17 825	17 204	**17 764**	17 657
Refined	Mℓ	10 678	11 186	11 556	**11 198**	11 652
Crude	Mℓ	4 534	5 462	4 510	**5 450**	4 910
Avtur	Mℓ	1 133	1 177	1 138	**1 128**	1 094
Gas	million m^3	489	511	509	**511**	515
Storage	Mℓ	315	597	553	**634**	366
Capacity utilisation (actual usage: capacity)						
DJP and NMPP	Mℓ/week	115:148	110:148	124:148	**106:148**	110:148
Crude	Mℓ/week	87:134	105:134	87:134	**104:134**	94:134
Avtur	Mℓ/week	20:24	23:24	20:24	**22:24**	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	135	139	167	**227**	174
Gas (actual usage: capacity)	million m^3/month	40:57	43:57	42:57	**43:57**	42:57
Service delivery						
'Off spec' volumes	litres per billion delivered	162 519	2 043 187	216 952	**—**	216 952
'Off spec' delivery events per thousand dockets	number	0,4	0,3	0,3	**—**	0,3
Ordered vs delivered volume	%	93	97	95	**98**	95
Planned vs actual delivery time	%	86	91	90	**89**	90
Sustainable developmental outcomes						
Employment (human capital)						
Training spend	% of personnel cost	3,0	n/a	2,5	**2,7**	2,7
Employee turnover	%	n/a	n/a	5,00	**5,15**	n/a
Employment equity	% of black employees	n/a	90	n/a	**91**	n/a
Absenteeism Index	%	315	n/a	2,5	**2,1**	n/a
Permanent employees	number	639	706	706	**674**	711
Female employees	% of headcount	n/a	n/a	n/a	**34**	n/a
People with disabilities	% of headcount	n/a	n/a	n/a	**1,97**	n/a
Risk, safety and health						
DIFR	rate	0,09	0,18	0,60	**0,70**	0,60

Financial performance review

Salient features		**Year ended 31 March 2020 R million**	Year ended 31 March 2019 R million	% change
Revenue		**5 732**	5 262	8,9
– Refined		**3 160**	2 941	7,4
– Aviation fuel		**66**	62	6,5
– Crude		**2 278**	2 056	10,8
– Gas		**114**	107	6,5
– Handling		**54**	37	45,9
– Other		**6**	6	0
– Clawback and levy		**53**	53	0
Operating expenses		**1 922**	1 266	51,8
– Energy costs		**322**	298	8,1
– Maintenance		**129**	117	10,3
– Materials		**5**	9	(44,4)
– Personnel costs		**473**	424	11,6
– Other		**992**	239	315,1
Profit from operations before depreciation, derecognition, amortisation and items listed below (EBITDA)		**3 810**	3 996	(4,7)
Depreciation, derecognition and amortisation		**1 282**	1 283	(0,1)
Profit from operations before items listed below		**2 529**	2 891	(12,5)
Impairments and fair value adjustments		**2**	24	(91,7)
Net finance costs		**908**	1 125	(19,3)
Profit before taxation		**1 618**	1 612	0,4
Total assets (excluding CWIP)		**43 210**	43 515	(0,7)
Profitability measures				
EBITDA margin[1]	%	**66,5**	75,9	(9,4)
Operating margin[2]	%	**44,1**	54,9	(10,8)
Return on total average assets (excluding CWIP)[3]	%	**6,5**	7,5	(1,0)
Asset turnover (excluding CWIP)[4]	times	**0,1**	0,1	0
Capital investments[5]	R million	**412**	326	26,4
Employees				
Permanent employees	number	**674**	672	0,3
Revenue per employee	R million	**8,5**	7,8	9

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 increased by 8,93% to R5,7 billion (2019: R5,3 billion), mainly due to the increase in petroleum allowable revenue of 7,69% granted by Nersa.
- Net operating expenses increased by 51,6% to R1,9 billion (2019: R1,3 billion). The significant deviation is due to an increase in environmental remediation and rehabilitation costs as a result of an unprecedented increase in pipeline theft incidents during the current financial year. Transnet Pipelines has implemented a number of initiatives, including strategic engagements with law enforcement agencies, regulators and government departments; security task teams; and aerial surveillance of pipeline infrastructure in order to address the significant risk to the security of supply of petroleum product.
- Consequently, EBITDA of R3,8 billion is 4,7% lower than the prior year (2019: R4,0 billion).

Looking ahead

- Pipelines with Nersa will finalise the NMPP prudency review.
- The Covid-19 pandemic has had a significant negative impact on the 2021 financial performance that will not be mitigated.
- Owing to the product theft incidents, there is a significant cost impact on the 2021 financial year relating to security initiatives and environmental rehabilitation.
- The Operating Division will continue with the Total and Sasol litigation resolution.

Capacity creation and maintenance

- Pipelines' capital spend for the year is R412 million compared to a target of R1,42 billion. The negative deviation is mainly attributable to delays in the construction of the Sapref R-Tanks and revisions of schedules on other projects.
- The decommissioning of the southern section of the DJP continued in the 2020 financial year.

Looking ahead

- Pipelines will achieve capital spend of R814 million for the 2021 financial year.
- Transnet Pipelines will continue with the following projects in the next financial year:
  - Construction of the Sapref replacement tanks
  - Upgrade of the Fire Protection System at its various sites
  - Control system development for the crude system
- Pipelines will finalise the FEL4 business case submission for the TM1 accumulator tanks.

Operational performance

Volumes

- The petroleum volumes transported for the period decreased by 0,3% to 17,764 billion litres (2019: 17,825 billion litres).
- Tarlton storage and handling volumes increased by 6,2% to 634 million litres (2019: 597 million litres). Although there has been an increase year on year, the target for year of 553 million was not met due to the SARS investigation on the cross-border volumes, which led to a significant reduction in volume performance at Tarlton.
- Gas volumes compared to the preceding year showed a slight increase of 1,6% to 511 million cubic metres (2019: 511 million cubic metres).

Capacity utilisation

- The NMPP capacity utilisation (actual usage: capacity) of 106:148 Mℓ per week (2019: 110:148 Mℓ per week) is lower than the target of 124:148 Mℓ per week as a result of commercial agreements that the customers entered into with the inland refineries.

Service delivery

- Customer satisfaction has improved from 65,7% (2019) to 69,5% in 2020. The level of customer interaction and engagements extended to include Exco's customer visits to better understand customer needs and to keep customers informed of the developments within Pipelines.
- Service delivery measures relating to ordered versus delivered volumes and planned versus actual delivery times were 97,5% and 88,9% respectively, compared to 97% and 91% in the prior year.
- Pipelines' operational cost per megalitre kilometre (Mℓ.km) of R227 per Mℓ.km is higher than the prior year actual of R139 per Mℓ.km due to high operating costs as a result of product theft.

Looking ahead

- The Covid-19 pandemic has significantly impacted the forecast economic environment for the 2021 financial year, which will impact Pipelines' plans to achieve petroleum volume performance targets of 17,656 billion litres for the 2021 financial year.
- The unprecedented number of product theft incidents poses a significant risk to the security of supply to the inland market.

Sustainable developmental outcomes

Human capital (employment and transformation)

- Pipelines achieved a permanent employee headcount of 674 against a target of 706
- Black employees represented 90,96% of the total employee base against a target of 90%.
- Female employees represented 34,37% of the total employee base against a target of 35%.
- People with disabilities represented 1,97% of the total employee base against a target of 3,3%
- The employee turnover rate is 5,15% compared to a target of 5%.
- The Absenteeism Index of 2,1% is lower than the target of 2,5%.

Looking ahead

- The impact of Covid-19 on Pipelines' business has been severe. Pipelines is looking forward to driving the developmental outcomes using the new ways of learning and new ways of talent management in support of business sustainability.
- Enhanced focus on people wellness and health.
- Embedding the Transnet Culture – new normal (Agility and Digitisation).

Skills development

- Pipelines achieved a training spend of 2,7% compared to a target of 2,5%.

Looking ahead

- Alignment with Transnet's Learning Strategy
- Focus on change management to drive the new ways of learning and a learning culture
- Mentorship of young talent through the Career Alumni for Pipelines.

Health and safety

- A DIFR of 0,70 was achieved for the year compared to a target of 0,60. The poor performance was largely attributed to a high number of motor vehicle incidents incurred in the financial year.
- Roll-out monthly driver awareness campaigns to sensitise personnel about road traffic safety with the aim being to reduce the number of MVAs and ultimately the DIFR.

Quality assurance

- Transnet Pipelines retained ISO 9001 certification status for the 2019/20 financial year.

Environmental stewardship

- Pipelines continued to implement a comprehensive Environmental Management System based on the ISO 14001 standard. Pipelines managed to maintain certification in line with the ISO14001:2015 standard.
- The product theft incidents have resulted in a number of sites that need to be rehabilitated and remediated in terms of the National Environmental Management Act.

Social accountability

- Enterprise Development (ED) initiatives amounted to R1,7 million for the year, including the following highlights:
  - Pipelines entered into a partnership with a third-party/conduit ED company to implement enterprise and supplier development (ESD) initiatives for the purpose of developing and sustaining small, medium and micro enterprises (SMMEs) that have the potential to become suppliers.
  - Pipelines continued to support SMMEs within its supply chain with early/favourable settlements. This will assist SMMEs with cash flow management.
  - SMMEs in need of any other support are directed to one of Pipelines' ED partners or to any of the Transnet ED/ESD hubs.

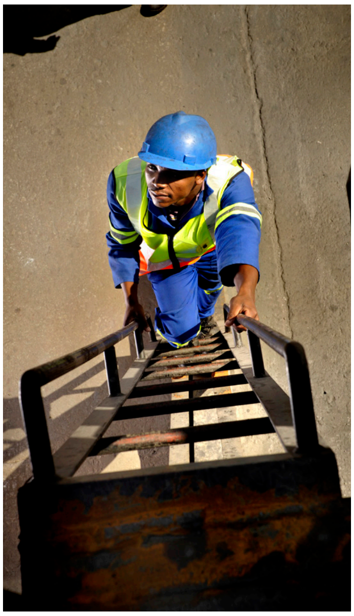
Key risks and mitigating activities

The top seven risks below were identified during the year under review with appropriate mitigating plans:

Key risks	Mitigating activities
Material payout in terms of Natref neutrality principle	• Termination of the letter of agreement • Commercial solution is being looked into in parallel with the litigation process
Delay in the completion of the Sapref R-Tanks as part of the NMPP	• Proactive management and monitoring of key milestone dates and activities as per the execution schedule
Non-completion of the TM1 accumulator tanks in time to meet demand	• Timeous approval of business case • Proactive management and monitoring of key milestone dates and activities once business case is approved
Delay in the delivery of a common user fuel import terminal	• Business case compilation and approval
High cost of doing business with Pipelines	• Capital optimisation programme • Cost-containment controls • Review of tariff smoothing strategies • Discounting of tariffs
DJP integrity (SBG-KRO and ALR-APT)	• Replacement of DJP sections with PL5 and PL6
Negative financial impact of Nersa NMPP prudency review	• DPE volume 1 and volume 2 reports submitted to the Minister of Public Enterprises • Engagement with Nersa on the Nersa NMPP prudency review

Opportunities

- Assist in enabling customers and key stakeholders that are of a strategic nature to improve market share
- Collaborate and align with other organs of state in order to positively contribute to improving the oil and gas infrastructure network
- Optimise the utilisation of the NMPP particularly from the coast by facilitating access to new market entrants in the network
- Improve the speed to market on business growth and development initiatives by strengthening the project management environment



Abbreviations and acronyms

CWIP	Capital work in progress
DIFR	Disabling injury frequency rate
DJP	Durban to Johannesburg Pipeline
EBITDA	Earnings before interest, taxation, depreciation and amortisation
Nersa	National Energy Regulator of South Africa
NMPP	New Multi-Product Pipeline
Sapref	Shell and BP South African Petroleum Refineries (Pty) Ltd
SARS	South African Revenue Service