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Transnet plans to speed up freight

State-owned freight and logistics group Transnet is one year into a R300bn, seven-year spendi plan. Early indications are that it is making progress.

For almost a decade, the parastatal has been involved in restructuring - first a range of disposals included splitting off SAA and businesses considered non-core - to focus on freight and logistics.

But despite the targeted approach, it was slow in delivering on its promise to bring down the cost of doing business in SA and to regain cargo lost to the over-loaded road network.

Its rail infrastructure is outdated, rolling stock use has been stretched beyond its lifespan, ports have seve capacity constraints and essential skills are in short supply.

To succeed in moving a significant proportion of goods from road to rail will require a drastic shift in the wa Transnet interacts with customers, greater attention to branch lines and investment in engineering, ports ar rail operational skills.

During the transition to democracy, Transnet's access to funding was severely limited. Bad management contributed to the malaise. Morale sank and investment activity, including maintenance, was almost non-existent.

Transnet's capacity constraints have been blamed for contributing to SA's inability to profit from the commodities boom. It has faced a barrage of criticism from companies that rely on rail to move bulk good and from shippers fed up with an inefficient but costly port system.

The average age of Transnet Freight Rail's fleet is 37 years. Just 11% of SA's inland freight is moved by rail, against 89% by road, according to last year's state of logistics survey conducted by the Council for Scientific and Industrial Research and Imperial Logistics.

But change, initiated in 2004, is slowly paving the way for better freight transport and logistics. Over the pa two years, a sense of energy - and urgency - is palpable, since Transnet's chief executive Brian Molefe to the helm.

Molefe says Transnet's "market demand strategy" has injected fresh oxygen into the organisation. With his R300bn vision, morale is lifting. Transnet's staff numbers are set to rise; newer, more efficient technology being purchased and training has increased.

Its intention is to meet customer demand for rail by growing volumes from 200Mt in 2012 to 350Mt by 201 It is also increasing port capacity and improving efficiency across its divisions.

Praise

Already, Transnet's customers are doling out praise. Mining houses, shippers, exporters of manufacturing goods, and the grain industry have welcomed an improvement in Transnet's customer relations, tangible adjustments to rail and port networks, better availability of wagons, quicker turnaround times and improvements in infrastructure.

Freight rail, the biggest beneficiary of the spending plan, has had some early successes. Nine years after was damaged by rain, farmers celebrated the reopening of the 15km line between Orkney and Vierfontein the end of last year. Its reconstruction cost Transnet Freight Rail R40m.

And by April, Transnet aims to complete an upgrade of the 85km Douglas-Belmont line in the Northern Cape, which has operated at only 50% capacity. The agricultural sector will again benefit.

Larger rail projects include the expansion of the iron ore line between mines in the Northern Cape and the port of Saldanha and Transnet's export coal line from Mpumalanga to Richards Bay.

Major investment is also under way at SA's ports, with a new terminal envisaged for Richards Bay.

But conditions for the parastatal were not always as conducive to investment. Ten years ago, Transnet wa jumble of subsidiaries comprising freight rail, pipelines, engineering, port terminals and the National Ports Authority. The business had 13 non-core assets in aviation, tourism, passenger rail, bus and trucking, soci services and telecommunications.

"Some divisions were profitable, but others, most notably SAA, were making spectacular losses," says Molefe. "Moreover, passenger rail relied on subsidies from the state to survive," he added.

A Ramos legacy

When Maria Ramos became chief in 2004, the organisation was making losses, was burdened by debt an services were fast deteriorating. Investment was at a standstill.

Her tenure was eventful. Dolly Mokgatle, then chief executive of Spoornet (before it was named Transnet Freight Rail), resigned after less than two years in the job. Mokgatle developed a turnaround strategy whicl was welcomed by Spoornet customers but failed to implement it fast enough for Ramos.

Transnet's entire board resigned in 2004, after taking responsibility for poor performance in the previous financial year, paving the way for a new team during Ramos's tenure. Ramos did get some flak for administerial, rather than operational, changes. She improved the state of Transnet's balance sheet instea of kick-starting overdue investment in infrastructure.

But one Transnet senior manager says: "You can never underestimate Ramos's contribution to Transnet. Unfortunately, chief executives have short contracts which don't allow them to see the benefits of changes they introduce within their contract period. Ramos set the tone for the improvements we see today."

Ramos cleaned up the balance sheet and restored Transnet's profitability, laying the foundation for its abil to borrow money on debt capital markets. Before Ramos, it was not possible for Transnet to talk about the next phase in its development, which is its R300bn investment in infrastructure, says Molefe.

He believes her legacy is the single value proposition she created for Transnet. By selling many of its non-core assets, she brought focus to the freight logistics group.

However, between Ramos and Molefe, Transnet lost two valuable years. Chief financial officer Chris Wells steered it through that period. Transnet managers describe Wells as a principled leader, but one who was never empowered to take decisions. He left after two years in an acting capacity.

Wells was also embroiled in a leadership tussle with Transnet Freight Rail chief executive Siyabonga Gam for the group chief executive position. Transnet's board was divided over retaining Wells or appointing Gama. Gama accused Wells of conspiring to thwart his appointment as group chief executive of Transnet

Before an appointment was made, Gama was suspended for breaching Transnet's procurement regulatio He retaliated with a court bid to overturn his suspension, but it was dismissed. An internal probe found him guilty and he was axed. However, this was later overturned on appeal, just as Molefe joined the organisatic

Changing culture

Under Molefe, Transnet's culture is changing. He began with a deliberate plan to change the parastatal's image. "For good or bad, Molefe makes decisions and that has been positive for Transnet," a manager tol the *FM*

Since his arrival in early 2011, the number of trains which Transnet operates has increased from 700 to 1400 a day. And there are improvements in all its divisions. But Transnet is still saddled with the results of bad decisions taken decades ago.

Gama says rail has inherited a legacy intertwined with the union of SA formed in 1910. The four unified colonies ran completely different rail systems. So a train travelling from what is now Gauteng through the Free State and into the Western Cape will have to change locomotives three times because provinces operate on different currents. Each time a different driver must be assigned.

By 2019, says Gama, 80% of these legacy issues will be dealt with. He likens the difference to that betwe a wheelbarrow and a conveyor belt.

Uniform wagons, compatible signalling systems and uniform braking systems are just some of the requirements of its new rolling stock and infrastructure. New locomotives will switch automatically between alternating and direct current.

Improvements already made have been of benefit largely to high-volume export commodities, while the inland market has not received the same level of attention. Besides late arrival and departure times, wagon availability has been a problem.

Junior coal miners, for example, deliver coal to Eskom's power stations via road. Until they can depend on more reliable rail network, they won't switch.

To compound an already large problem, Transnet had a rocky 2012/13 financial year, which was the start of its seven-year plan. Industrial action stymied volume targets. Despite additional capacity on the coal line to Richards Bay, low international coal prices led to lower exports.

And problems between customers added to the challenges. Differences between ArcelorMittal SA and

Kumba Iron Ore have resulted in wagons being parked outside the Sishen iron ore mine in the Northern Cape, says Molefe.

Molefe has had to tighten spending in the hope that revenue lost from lower volumes can be recovered elsewhere.

And with an uncertain outlook for the global economy, the problems may not be limited to the past year. If Transnet is unable to achieve sufficiently high volumes, it may be forced to cut back on its capital investme plans.

The worst-case scenario, says Molefe, is a R50bn reduction in spending but says such a cutback is unlike

Funding expansion

To fund the expansion plans one-third of the revenue will be borrowed without a government guarantee. Borrowing from local debt capital markets will be augmented with global markets. Leading the borrowing w be newly appointed chief treasurer Mathane Makgatho

Last year, Transnet successfully issued a R1bn bond in the US - its biggest overseas bond - which Molefe says was eight times over-subscribed. "We had R8bn for the taking. It's an indication that markets are bull about Transnet."

Other sources could include development finance organisations (it negotiated a loan with the African Development Bank in 2010), bank loans and facilities with multilateral export credit agencies.

Key to this will be a firm intention to keep gearing rates at respectable levels. This means that its reliance o internally generated revenue will remain high.

"Borrowing does not allow us to generate revenue internally. Rather, internal revenue gives us the ability to borrow," Molefe says.

The bulk of the funds - R200bn - will be sourced internally from the tariffs it levies on users of ports, rail an pipelines. The reliance on internally generated revenue, however, will depend on an increase in the volume of goods that Transnet moves.

New projects must have a proven revenue stream before they get the nod but this has always been the case. Transnet chairman Mafika Mkwanazi admits that the port of Ngqura in the Eastern Cape was decided on even though studies suggested it would not be practical. Transnet has no regrets today and has decide to add to that investment.

Transnet National Ports Authority chief executive Tau Morwe says Ngqura is a good investment for Transn despite initial misgivings about its sustainability.

It was originally planned on the basis of the construction of an aluminium smelter at the Coega industrial development zone. Though this didn't materialise, Morwe says the port has flourished. The old liquid bulk facility and manganese terminal at the Port Elizabeth port will be decommissioned and built at Ngqura. It w also consider ship repair and bunkering facilities at the port.

Morwe says financial sustainability underpins Transnet's investment programme. Projects are aligned with government's integrated infrastructure planning, but sustainability is essential because of its reliance on revenue to recoup its investments.

Infrastructure required

Analysts believe financial viability is not always a priority. The director of the Centre for Supply Chain Management at Stellenbosch University's logistics department, Prof Jan Havenga, says Transnet must provide infrastructure that the country needs and not necessarily what its balance sheet can bear. This means that the pressures on the balance sheet can be severe, but he says its current management has been quite successful in obtaining funding.

Mkwanazi says proven revenue will remain critical in future. He also stresses that management has to be mindful of global changes and be aware of the market and economy when it takes decisions on large investments.

"We don't want to run with a particular line of spending only to find out that market conditions have change

With coal, for example, Transnet needs to be involved in the department of minerals and energy-led task team investigating how the declaration of coal as a strategic mineral will change usage patterns.

So could Transnet fall victim to political decisions that it may be forced to implement? The only political decision will be the final sign-off on the dig-out port planned for the old airport site in Durban, says Mkwan It involves multiple ministries and entities.

Everything else will be based purely on studies that demonstrate financial practicality.

Havenga says that, historically, transport management and policy-making has been fraught with political interference. Today, however, it is barely a problem.

"My view is that political influence is at its lowest level ever. I am quite aware of objectives that political leaders have given to Transnet. These are to enable modal shift, increase rail volumes and persist with infrastructure development in line with demand, as well as government's development-state ideals."

If Transnet continues its drive to support national development goals, Havenga says, it does not need protection from politicians. Many branch lines were built to support commercial farmers, who were also th major constituency of the government in the early 1900s. These lines were often not practical, says Havenga.

He says there are also cases dating back to the 1880s when oxwagon freight service providers tried to bl rail development through political meddling.

But Transnet has attracted sustained criticism over branch lines, largely from companies that would like to use them. This may soon change. Public enterprises minister Malusi Gigaba is expected to announce soo that three branch lines are to be run by the private sector on concession. Molefe says others will be identified.

Private investment

Gama says there are other opportunities for partnerships, including private investment into bulk terminals, rapid loading facilities and specialised wagons.

But branch lines, particularly low density ones, are tricky. Havenga says they are one of the major obstacle to Transnet's success. Railways are driven by fixed costs. Higher volumes over the same track are critical That this has not taken place in SA is due mostly to circumstances beyond Transnet's control, says Havenga. Most branch lines are low density and were not built with revenue in mind.

Havenga believes high-density and low-density lines should be managed separately and privatised separately, even if they remain within Transnet.

Low-density lines should receive subsidies or be managed as subsidised concessions. He believes that t is what Transnet's strategy aims to do. Branch lines are not generally located on high-density freight routes As a result, when Transnet went to market with concession offers for these lines in 2010, the level of intere was disappointing.

Subsidised concessions will also remove the burden of cross-subsidisation between high- and low-densit lines.

"The required subsidy will be relatively small and some lines will become viable within 10 or 20 years. To rebuild abandoned lines then will be expensive," Havenga says.

Allen Jorgensen, media and research officer of the Railroad Association of SA, says government should regard these lines as a social asset and as tools for rural development and agriculture. It should underwrite infrastructure costs and, in some cases, even operating costs in an effort to bring life to these lines.

But Transnet's resistance to allowing the private sector on to its turf will hamper the development of rail, he says. "The perception of rail transport created over the past three decades is that of an industry that's dea

At the ports, Morwe says the National Ports Act stipulates that all projects be put out to tender. For instanc the construction of the liquid bulk facility at the port of Ngqura is being done by a private consortium, Oiltanking Grindrod Calulo. Dry dock terminals intended for Saldanha Bay and Richards Bay will also go to tender, says Morwe.

But there are other concerns. Jorgensen says Transnet has lost critical engineering expertise. Coupled wi that, it has lost operational staff. Train drivers have been fast-tracked into positions after three months of training. In the past, he says, this was a process that took 10 years. Skills, he says, will be an important determinant of the success of its investment plans.

Moreover, government must develop a transport policy that treats road and rail fairly. Currently, private cars are subsidising road freight because there is no mechanism to charge appropriate fees to road freight operators. This is distorting transport and logistics infrastructure in SA.

Source: *Financial Mail* via I-Net Bridge