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The Chairman, Ports Regulator
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Re: Columbus Stainless (Pty) Ltd submission to the National Port Regulator – Review of the 2015/16 – 2017/18 Tariff Methodology

Introduction

Columbus is a stainless steel manufacturing plant situated in Middelburg, Mpumalanga. Being the only manufacturer of stainless steel flat products in Africa, the Columbus market consists of 75% of material being exported and a local market of 25%. Columbus imports its raw materials from various countries around the world, with shipments going through the Durban port terminal. The majority of the Columbus market is exported through the Durban and Richards Bay port terminals. Columbus aims at being a globally competitive producer and preferred supplier of stainless steel. There are major logistical challenges that are continuously being faced as the South African Port of discharge is of substantial distance from the Columbus manufacturing plant. It is critical for Columbus to address these challenges by streamlining internal manufacturing processes and competing in the global market by reducing supply chain costs.

Columbus Manufacturing Plant

In line with the review of the 2015/16-2017/18 Tariff Methodology, comments will be made as follows;

a) NPA's Tariff Application revised marine revenue for FY 2017/2018 to FY2019/20, tariff increase of 8%

b) Comment on the 2015/16-2017-18 Tariff Methodology

a) Comments on the NPA's Tariff Application revised marine revenue for FY 2017/2018 to FY 2019/20 tariff increase of 8%

The objective of the National Port Act is *"to promote the development of an effective and productive South African Ports Industry that is capable of contributing to the economic growth and development of our country"*

The NPA has applied for an 8.00% tariff increase for FY2017/18 and indicative tariff increases of 25.11% and 9.54% for FY2018/19 and FY2019/20 respectively.

In a globally competitive market, majority of the port capital costs are funded by the state. Reason being, it is in the high interest of the state to boost the economy. While the regulator categorises port users and their level of **asset usage** to determine where the burden of the asset cost allocation should be, a portion should be allocated for **state assistance**. This will lower tariff increases imposed on cargo owners and attract investors and shipping lines.

The phased approach that is envisaged by the regulator over the next few years is proposed as follows for fair asset usage allocation;

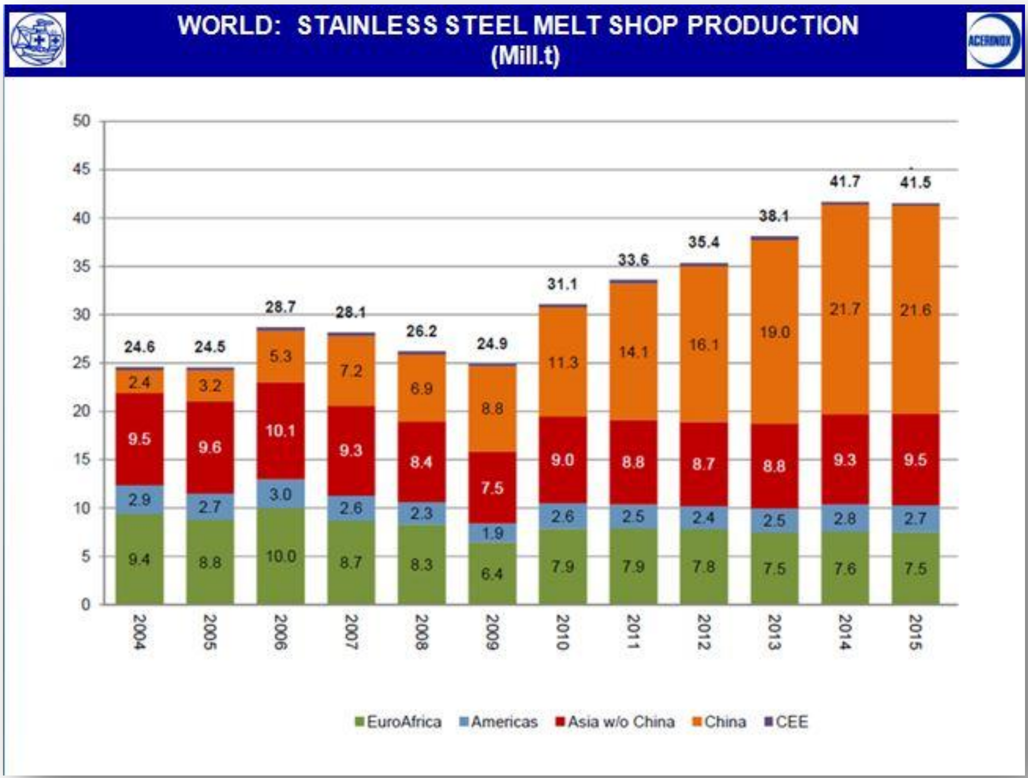
- Cargo Owners: -5% real price decrease on an annual basis
- Shipping Lines: 7.2% real price increase on an annual basis; and
- Tenants: 2.8% real increase on lease revenue on an annual basis.
- **Government**

The bulk of the costs are said to move over from cargo owners to the shipping lines within the next few years. This brings relief to cargo owners, however it can be further reduced by re-assessing and increasing the tenant's tariff adjustment.

Companies around the world are placing focus on increasing productivity while optimizing and reducing supply chain costs. Columbus Stainless (Pty) Ltd is export driven and based on supply and demand in the global market. Continuous improvements and strides have been taken to reduce supply chain costs and efficiencies taking into account the logistical costs and distance from the manufacturing plant to the ports. The port tariff system also should indicate a high level of efficiency improvements to reduce port charges year on year.

There are numerous factors that need to be taken into account when deriving the tariff adjustments. The usage of assets is just one portion that cannot be a standalone factor for tariff adjustments. The cognisance of the country's economy, global competitiveness should not be hindered, prices should be charged in line with the inflation rate. And there should be evident high levels of efficiency and improvements made which are demonstrated by a reduction in port tariffs.

The stainless steel industry has become highly competitive with the Chinese market acquiring 52% of the world stainless steel production in 2015. With Columbus being a value adding manufacturer in the South African economy, remaining cost effective throughout the entire supply chain while increasing productivity is a high priority.



It is understood that the NPA has to recover port investments and remain profitable; The cost of investments is spread over the useful life span of the infrastructure to reduce costs. The main goal is to use an approach that will boost the South African economy, attract investors and not an approach that is used mainly to recover investments. The aim is an export led growth driven by initiatives to improve costs and effectiveness.

The global market, in particular the stainless steel industry is under economic pressures to continuously streamline operations, restructure, reduce lead times and cut supply chain costs, in order to remain competitive and boost part of the South African economy. The NPA is responsible for implementing, managing and controlling all port related and marine service. The evidence of continuous improvement strategies should be shown in reduced and globally competitive tariffs.

The NPA is a state owned company, while it is understood that port investments need to be recovered, the objective is to boost the South African economy and spread costs incurred evenly and in proportion between all affected parties. This is illustrated in figure 7: Transition to the Regulators Tariff Strategy on page 52 of the NPA's tariff application. The next few years to get to the phased approach can be reduced with a proportion allocated to state assistance. The fact that cargo owners are currently paying 56% of the NPA's investment, not taking into account the profitability of these investments, until the envisaged proposal is carried out is of concern.

Columbus Stainless (Pty) Ltd is a value adding manufacturer of stainless steel products. With an export market of 85% shipped through the Durban and Richards Bay Port Terminal, Columbus opposes the 8.00% increase for FY2017/18. Taking into consideration the inflation rate, economic pressures and volume growth in South Africa Columbus believes a **4.7% increase is justifiable.**

The NPA is part of the Transnet stable and collectively all three divisions namely NPA, TPT and TFR are the highest cost related service in South Africa. Private tenants and Transnet Port Terminals rent directly from the NPA as terminal operators, however TPT are +-20% more expensive in facilities adjacent to one another for exactly the same port service.

b) Comments on the 2015/16-2017-18 Tariff Methodology

The pricing method that is used is based on accounting methods and does not make provisions for other factors that contribute to an effective and globally competitive port to be taken into account.

The volume growth percentage increase of 1.8 % should be reviewed with GDP growth as per a relevant South African economic institution. If the forecast of GDP is lower than 1.8 %, which can be supported by a slowdown in commodity demand and a contraction of the manufacturing sector to a lower capacity then a downward movement of 1.8% is justified for the next three years. This should be in line with initiatives in enhancing the export capacity of South Africa in a world that's in a "recessionary environment" with depressed commodity prices.

In the revised Revenue Requirement calculation for FY 2017/18 to FY 2019/20 an (ETIMC – Excessive Tariff Increases Margin Credit) of R98mil was included. An ETIMC, which is considered by the regulator as crucial to avoid future tariff spikes, by retaining and increasing the NPA's ETIMC. The ETIMC is revenue collected from the port users. The regulator authorises all or part of the value of the ETIMC facility, to tariff increases that are in excess of the inflation forecast. With South African port charges being amongst the highest port charges globally, it would be of value to Columbus and all stakeholders for the regulator to show the % of ETIMC that is qualified for in ranges of tariff increases. This needs to be smoothed out.

The clawback does not match cash flow investments.

Both the NPA and Port Regulator are in agreement that the Required Revenue method is not designed for ports and that with the absence of a better model, the RR method is used. The RR method does not provide any incentive to improve productivity by reducing costs. The RR model is viewed as a cost plus mark up method.

Transnet as an entity with the NPA, partly does not provide a market related service and with the monopoly it has, it is more of a "take it or leave it".

Conclusion on comments made

- Taking into consideration the inflation rate, economic pressures and volume growth, Columbus proposes that a 4.7% increase will be justifiable for FY2017/18.

- The tariff determination takes into account only accounting based costs. In order to be competitive, provisions need to be made for continuous improvement savings. Prices should allow for cost recovery made on improvements.

- The NPA is to move over to the Department of Transport and not the Department of Enterprise.

- The NPA should incorporate charging asset usage charges per commodity type as per volume throughput. The more volume throughput per commodity, the higher the usage of infrastructure. Cargo Dues on imports and exports as specified in the tariff book should be classified and priced on volumes per commodity.

- Cargo Dues on imports and exports should also be grouped and classified as per value adding status to the South African economy. The more value adding a product is, the less cargo dues are charged as this will create a competitive port price for the export of value adding goods.

- Port tariff charges should be customised as per port within South Africa. It does not make any business sense to pay for infrastructure at a Port that is not being used by the company. Each port requires its own pricing structure and asset usage at each port.

- Revenues are mostly for capital expenditure and operating costs. This leads to over staffing, high investment costs, inefficiency and high tariff increases. The NPA is proposed to relook their employment strategy. An efficient employment strategy needs to be implemented to ensure that the main goal is effectiveness.

- The forecasted volume that is used in the NPA's development plan is based on Transnet Corporate Plan for short term guidelines. It is recommended to use an independent and relevant South African economic institution.

- A portion of the asset cost allocation should be given to the government for state assistance to relief cargo owners and better the current state of high port costs in South Africa.

- There is a conflict of interest and competitiveness with the NPA being the port landlord and TPT being the terminal operator but also the NPA's sister company. The portion of asset cost allocation for tenants should be increased as a competitive strategy over a shorter period of time, to allow for a marginally proportionate asset cost allocation.

- Asset values do not depreciate, yet depreciation is included. It does not make any senses to pay depreciation on assets.

- Working capital can be manipulated (AR+Inv-AP). Higher costs are caused through poor cash management practices.

- Operating costs include vacancies. It does not make any business sense to include costing for vacancies.

- The NPA is required to include targets that they have set for the upcoming financial years.

Based on the above mentioned comments, we trust that the Port Regulator will take Columbus Stainless (Pty) Ltd comments into account during the tariff application determination.