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N29

The Chairman,
Ports Regulator,
Private Bag X54322,
Durban,
4000

30th September, 2016

Dear Sir,

NPA TARIFF APPLICATION 2017/18: SUBMISSION BY NAAMSA ON BEHALF OF THE SOUTH AFRICAN AUTOMOTIVE INDUSTRY (VEHICLE MANUFACTURERS, EXPORTERS AND IMPORTERS)

The National Association of Automobile Manufacturers of South Africa would like to thank the Ports Regulator of South Africa as well as the Transnet National Ports Authority for their continued efforts to drive port pricing in a direction that is accurate, equitable and increasingly globally competitive.

The association's members are appreciative of the considerable advances made on behalf of our industry in recent years, most notably the effective application in FY2016/17 of the maximum 60% discount across all stakeholders. This has resulted in welcome cost reductions and represents a significant step towards achieving the objectives of the Pricing Strategy, namely that port costs be reflective of port asset utilisation.

As the largest manufacturing sector within the economy, responsible for significant beneficiation, policy certainty remains one of the most important requirements when positioning our industry to compete globally. It is long-term strategic planning such as the Pricing Strategy and Automotive Production Development Programme that enable our industry to secure Foreign Direct Investment for local manufacturing operations.

NAAMSA hereby submits its comments in response to the NPA Tariff Application for 2017/18, in the hope that our reasonable requests will be considered to be in the best interests of South African port users and consumers.

Yours sincerely,

Francois Retief

CHAIRPERSON NAAMSA SUPPLY CHAIN WORKING GROUP

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Introduction and Background

The National Association of Automobile Manufacturers of South Africa ("NAAMSA") welcomes the opportunity to provide comments on the Transnet National Ports Authority's ("NPA" / "Authority") 2017/18 tariff application. As the industry representative of 22 motor vehicle manufacturers and 21 motor vehicle importers and distributors, the importance of the Ports Regulator of South Africa's ("Regulator") engagement process is appreciated and considered fundamental to ensure that South African port users have unhindered and equitable access to a competitively priced port network.

The automotive manufacturing sector contributes 7.5% to GDP and is the largest manufacturing sector in the economy contributing to about 33.5% of South Africa's manufacturing industry output (FY15 actual results). The industry is highly dependent on international trade and more specifically a competitively priced ports network which will allow the South African automotive sector to effectively compete with other global automotive manufacturing sources for export contracts.

The below stakeholder comments are submitted within the context of the Tariff Methodology for 2017/18 having been approved by the Regulator and on the assumption that this has been correctly applied by the NPA to determine the Required Revenue for the application period. Furthermore the submission takes cognisance of the long-term Pricing Strategy that has been approved by the Regulator, which sets out the principles of port pricing. It is noted that while the Pricing Strategy provided an indicative end state recovery mix by port users, this was based on data analysis at the time of publishing and will remain subject to on-going adjustment to account for the dynamic input variables that affect tariff setting within the broader guiding principles.

The comments herein will primarily address Cargo Dues and in particular those relating to the automotive industry. It is noted however, that the effect on other Cargo Owners and port users has not been ignored in view of the zero-sum nature of the Required Revenue methodology. It is further recognised that Tenant Charges remain contract driven (under bilateral negotiations between NPA and Tenants) and are therefore not subject to the same level of price elasticity as those levied on other port users. However, we trust that the Regulator is overseeing that tariff rationalisation is taking place in this area in line with the Pricing Strategy and that the upcoming re-valuation of port assets will be considered when determining market related rentals going forward.

The automotive industry remains particularly sensitive to port pricing. As such any cost reductions in line with the Pricing Strategy and efficiency gains within the port system will assist the industry in the current challenging trading environment locally and abroad. This would improve the industry's global competitiveness on vehicle and component exports as well lower inbound costs translating into end user savings on purchases.

Tariff Application

The NPA has applied for a Total Revenue Requirement of R12 207m for the financial year 2017/18. The Authority forecasts Real Estate revenue from Tenants to recover R2 798m, and that the balance of R9 409m should therefore be recovered from Marine Revenue (Marine Charges to Shipping Lines and Cargo Dues to Cargo Owners). This would translate into an average tariff increase of 9.14% compared to the prior year.

The NPA has therefore requested access to R98m of the Excessive Tariff Increase Margin Credit (ETIMC) in order to cushion the effect of the proposed average tariff adjustments. If approved this would result in a reduction of the Marine Revenue Requirement down to R9 311m and resultant average tariff increase of 8%.

In accordance with the Pricing Strategy, aiming to position tariffs at levels commensurate to port asset utilisation, the Authority has further proposed that the tariff increases be differentiated as follows:

- 13.25% on marine charges;
- 8.30% on all bulk;
- 5.00% on containers; and
- 5.00% on automotives.

Utilisation of ETIMC

The ETIMC at the end of FY2016/17 is expected to amount to R2 536.5m according to the Record of Decision (ROD) relating to the period. As such, the application request for R98m represents approximately 3.86% of the total reserves.

Table 5: ETIMC calculation

Transaction type	R million
2012/13 ETIMC retained	900
2012/13 WACC return on ETIMC (average ETIMC across year)	20
2013/14 ETIMC opening total	920
2013/14 Estimated ETIMC retained in 2013/14	1 378
2013/14 ETIMC closing total	2298
2013/14 Average ETIMC	1609
2013/14 WACC return on Average ETIMC	60
2013/14 ETIMC closing balance	2 358
2014/15 Average ETIMC	2 358
2014/15 WACC return on average ETIMC	*108.3*
2014/15 ETIMC closing balance	2 466
2015/16 ETIMC Utilised	-150
2015/16 WACC Return on ETIMC	108.5
2016/17 WACC return on ETIMC	112
2016/17 ETIMC Total	**2 536.5**

Source: *Ports Regulator's Record of Decision – Tariff Application 2016/17*

In the absence at this point in time of a defined strategy to utilise the ETIMC, it is proposed that the Regulator consider pro-rating the total, adjusted annually, in line with the with the Authority's

capital investment programme(s) for the foreseeable future bearing in mind resultant increases in operational costs arising from the CAPEX.

Latest projections indicate TNPA's expenditure in terms of the Market Demand Strategy ("MDS") will total R42bn over the next 7 years, with R 4 050m (±10%) earmarked for 2017/18. However, it is noted that major capital assets, including the Durban Dig-Out Port (DDoP), do not currently form part of the Regulatory Asset Base (RAB) but will certainly be included at some point in the future. Additionally, the Regulator is currently in the process of conducting a re-valuation of the Authority's assets. These processes could each have a considerable impact on the Authority's Required Revenue in the coming years.

As such, we are therefore reliant at this point in time on the Regulator's judgement with regard to ETIMC utilisation, based on the office's greater insight into the extent of the capital expenditure programme rollout, funding mechanisms as well as the aggregate projected industry volumes.

Pricing Strategy for the South African Ports System

In 2015 the Regulator approved the Pricing Strategy for the SA Ports System, which would take effect from 2016/17. The strategy outlined the long-term principles that would guide the Authority to set tariffs and charge rentals commensurate to port asset utilisation by the port users within the context of achieving the Required Revenue for the period.

The Pricing Strategy indicated that with all things remaining constant based on 2013/14 data, the end state cost recovery allocation would reflect the following:

Total Revenue Required (RR) would be recovered, based on the below asset allocation principles, as follows:

- Tenants would account for 29%
- Shipping Lines would account for 36%
- Cargo Owners would account for 35%

The Cargo Owners Revenue Requirement would be recovered, based on proportional number of vessel port calls, as follows:

- Dry Bulk would account for 29.7%
- Liquid Bulk would account for 9.5%
- Break-Bulk would account for 7.7%
- Containers would account for 45.5%
- RoRo would account for 7.5%

The RoRo Revenue Requirement would be recovered, based on the total number of units and the import/export split thereof, as follows:

- Import Tariff at R51.30
- Export Tariff at R25.65

It was noted however, that due to the current imbalances in the tariff book, the Pricing Strategy would likely take a period of 10 years (or more) to be fully implemented.

Request for Updated Pricing Strategy

It is noted that based on the assumption of "all things remaining constant" the indicative end-state tariffs were determined using data at a specific point in time. It is further assumed that these calculations have been periodically updated by the Regulator, not only to assess the impact of tariff determinations, but also to revise the dynamic inputs of each sector that shape the outcome of the strategy for all other port users.

May we kindly request that the Regulator consider publishing an updated Pricing Strategy on an annual basis. This would enable the Regulator to update the allocation attributable to each port user as well as the forecast end state tariffs, taking into account the actual tariffs, volumes and revenues in each financial year. It would also account for any changes in the tariff methodology that may affect the "size of the pie" and resultant forecast end state tariffs.

The above would empower port users to assess the extent to which the strategy has been implemented and objectives achieved. The publication would furthermore act as a mechanism to manage port user's expectations and could also serve as a mechanism to propose minor adjustments to the strategy if deemed necessary.

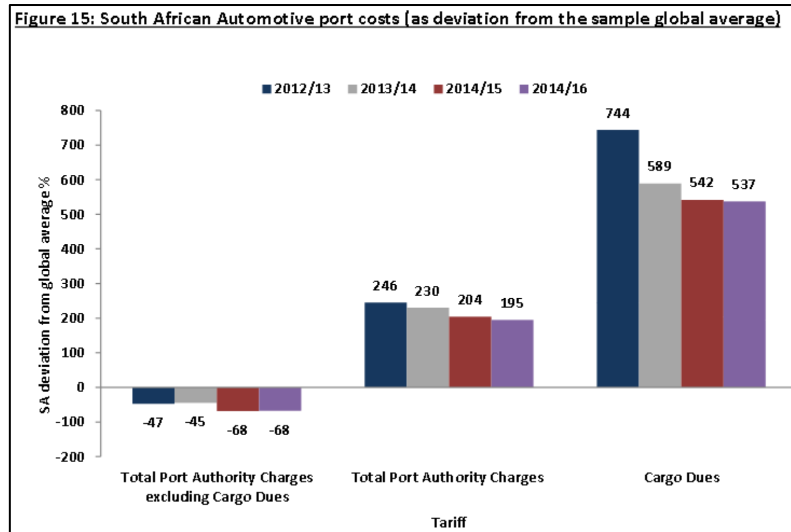
Current RoRo Tariffs

The current (2016/17) RoRo tariffs are:

- R90.33 for Imports; and
- R35.64 for Exports.

Furthermore, there is also no longer any differentiation according to volumes, so every Cargo Owner contributes equally per unit through the port, based on their activity (Import or Export).

The contribution by the automotive industry, based on the above tariffs, represents a deviation from the global average of approximately 500% according to the Regulator's 2015 Global Pricing Comparator Study (GPCS). While industry accepts that our port funding model is relatively unique in that it is fully funded by Port Users, nevertheless it remains important to ensure that local port pricing remains competitive compared to global comparator ports.



Source: *SA Ports Regulator Global Port Pricing Comparator Study 2014/15*

Projected RoRo End State Tariffs – 2017/18 Terms

In order to provide context to this submission, we shall attempt to project what the proposed end state RoRo tariffs would be, in 2017/18 terms. All volumes and allocations are assumed to be in accordance with the Pricing Strategy based on 2013/14 data.

The Total Revenue Required, in terms of the 2017/18 NPA Tariff Application, is expected to be allowed at R12 109m assuming that the ETIMC request is granted.

Based on proportional allocation by Port Users, the Required Revenue from each sector would be:

- Tenants @ 29% = R3 512m
- Shipping Lines @ 36% = R4 359m
- Cargo Owners @ 35% = R4 238m

Similarly the allocation of Cargo Owner's Required Revenue from each CHT would be:

- Dry Bulk @ 29.7% = R1 259m
- Break-Bulk @ 7.7% = R326m
- Liquid Bulk @ 9.5% = R403m
- Containers @ 45.5% = R1 928m
- RoRo @ 7.5% = R318m

Finally, the RoRo tariffs based on total units as well as the import/export split thereof would be:

- Import Tariff = R68.07
- Export Tariff = R34.03

Projected RoRo End State RoRo Tariffs in Today's Terms
Comparison to Actual and Applied for Tariffs

			Pre-Tariff Strategy		Tariff Strategy Implementation	
		End State Allocation	Base Year - 2013/14		Year 1 - 2016/17	Year 2 - 2017/18
Total Revenue Required/Allowed:	Increase		Base Year = 0%		121.24%	109.45%
Total Revenue Required/Allowed:	Revenue		R 9 126		R 11 064	R 12 109
Allocation of Total Required Revenue to Port User Group:	Tenants	29.0%	R 2 647		R 3 209	R 3 512
Allocation of Total Required Revenue to Port User Group:	Shipping Lines	36.0%	R 3 285		R 3 983	R 4 359
Allocation of Total Required Revenue to Port User Group:	Cargo Owners	35.0%	R 3 194		R 3 872	R 4 238
Allocation of Cargo Owners Required Revenue to Cargo Handling Type:	Dry Bulk	29.7%	R 949		R 1 150	R 1 259
Allocation of Cargo Owners Required Revenue to Cargo Handling Type:	Break Bulk	7.7%	R 246		R 298	R 326
Allocation of Cargo Owners Required Revenue to Cargo Handling Type:	Liquid Bulk	9.5%	R 303		R 368	R 403
Allocation of Cargo Owners Required Revenue to Cargo Handling Type:	Containers	45.5%	R 1 453		R 1 762	R 1 928
Allocation of Cargo Owners Required Revenue to Cargo Handling Type:	RoRo	7.5%	R 240		R 290	R 318
Adjusted End State RoRo Tariffs:	Import		R 51.30		R 62.19	R 68.07
Adjusted End State RoRo Tariffs:	Export		R 25.65		R 31.10	R 34.03
			2013/14 Actual		2016/17 Actual	2017/18 Application
			60% Disc	0% Disc	No Discounts	No Discounts
Comparison of Actual & Applied for Tariffs to End State Tariffs:	Import	Tariff	R 82.38	R 205.94	R 90.33	R 94.85
Comparison of Actual & Applied for Tariffs to End State Tariffs:	Import	% of 2017/18 End State	121%	303%	133%	139%
Comparison of Actual & Applied for Tariffs to End State Tariffs:	Export	Tariff	R 32.50	R 81.25	R 35.64	R 37.42
Comparison of Actual & Applied for Tariffs to End State Tariffs:	Export	% of 2017/18 End State	95%	239%	105%	110%

Assumptions:
Required Revenue allocations to **Port User Groups** remain in accordance with the Tariff Strategy based on 2013/14 Data
Required Revenue allocations to **Cargo Handling Types** remain in accordance with the Tariff Strategy based on 2013/14 Data
RoRo Total Volumes and Import/Export split remain in accordance with the Tariff Strategy based on 2013/14 Data

Current & Applied for Tariffs Compared to Projected RoRo End State Tariffs

According to the above analysis if the current RoRo tariffs were to remain unchanged, they would remain higher than the projected end state tariffs, in2017/18 terms, by approximately:

- 33% on Imports; and
- 5% on Exports

Furthermore, if the current RoRo tariffs are decreased by 5%, the deviation from the projected end state tariffs, in2017/18 terms, would be approximately:

- 25% on Imports; and
- 0% on Exports

If however the NPA's application to increase the RoRo tariffs by 5% is approved, the deviation from the projected end state tariffs, in2017/18 terms, would be increased with the difference being approximately:

- 39% on Imports; and
- 10% on Exports

The intention of the NPA, proposing tariff increase differentiation in line with the Pricing Strategy, is noted and appreciated. However, the analysis highlights the contradictory effect of applying the proposed increase onto the highly inflated RoRo base tariff.

Motivation for RoRo Tariff Decrease

The industry believes that a 5% decrease, in order to accelerate tariff rationalisation, would be in in the best interests of South African manufacturers and consumers.

The decrease would maintain the Import tariff at 25% above the anticipated end state in 2017/18 terms, whilst perfectly aligning Export charges with their deemed port asset utilisation. Furthermore, the nominal effect on other port users would be almost negligible, since the RoRo contribution to Total Revenue Required is fractional.

The nominal effect of the 5% decrease translates to approximately R21m saving for the automotive industry.

RoRo Tariff Decrease - In Nominal Terms					
	Volume	Current Tariff	Proposed Tariff	Tariff Discount	Revenue Discount
Imports	414 361	R 90.33	R 85.81	R 4.52	R 15 720 276.23
Exports	361 959	R 35.64	R 33.86	R 1.78	R 5 418 091.88
Total	**776 320**				**R 21 138 368.11**

Assumption:
"Other" Automotive Volumes from Table 12 of the NPA tariff Application 2017/18 were
pro-rated to import and export volumes in their respective proportions
RoRo Cargo Dues Formula = Tariff X 2 X Vehicle Length
Average vehicle length assumed to be 4.2m

If the R21m was pro-rated across Dry Bulk, Liquid Bulk, Break Bulk and Marine Charges, all of which were considered to be currently charged below their proportionate port asset usage, they would each incur a miniscule 0.51% Tariff Increase.

RoRo Tariff Decrease - Effect on Other Port Users				
	2016/17 Revenue Forecast	Ratio	RoRo Savings Apportioned	Revenue/Tariff Increase Required
Break Bulk	R 229 000 000	5.49%	R 1 159 446	0.51%
Dry Bulk	R 1 086 000 000	26.01%	R 5 498 507	
Liquid Bulk	R 647 000 000	15.50%	R 3 275 814	
Marine & Other Revenue	R 2 213 000 000	53.01%	R 11 204 601	
Total	**R 4 175 000 000**	**100.00%**	**R 21 138 368**	

Furthermore, when you consider the above proposed tariff increase against the trading values of such commodities the impact is almost non-existent and would certainly not affect their ability to trade. By way of example we consider the effect of the above on the export price of three significant Dry Bulk commodities:

Proposed Tariff Increase Effect on Dry Bulk Commodities					
	Trading Spot Rate	Trading Rand Value	Export Tariff	Proposed Increase	Proposed Increase as % of Spot Rate
Commodity "A"	$59.16/Ton @ 6 SEP	R 828.24	R 8.41	R 0.04	0.005179%
Commodity "B"	$1 650/Ton @ 31 MAY	R 23 100.00	R 8.41	R 0.04	0.000186%
Commodity "C"	$40.00/Ton @ 13 SEP	R 560.00	R 3.37	R 0.02	0.003069%

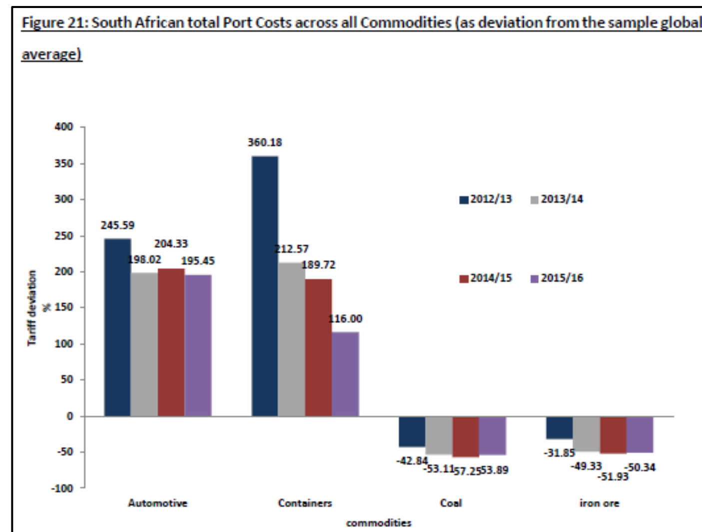
Port Charges in relation to the National Development Plan 2030

The National Development Plan (NDP) 2030 issued in August 2012 by the National Planning Commission (which forms part of the office of the Presidency), provides a blueprint for the South African economy to eliminate poverty and reduce inequality by 2030. The plan essentially aims to elevate South Africa's growth and development, to reduce unemployment and create a sustainable future for all who live in South Africa.

The NDP contains several sections which provide direction with relation to port charges to stimulate growth and employment within the manufacturing sector. Firstly, the NDP identified that South African "…ports are characterised by high costs and substandard productivity relative to global benchmarks." (NDP, 2012, p183). Furthermore the NDP (2012, p148) also argues that, "..to compete, the country's cost structure requires an emphasis on productivity, products and logistics. The most important contributions to manufacturing expansion will be in relation to the business environment. Challenges relate to the availability and cost of electricity; the efficiency of the logistics platform; the quality of telecommunications; and fast-rising administered pricing for electricity, transport, fuel, and fertilizer…".

"South Africa is a relatively small market, far from major trading partners. In addition, it has a history of economic development skewed by isolation and apartheid. These factors have resulted in major sectors of the economy developing in an uncompetitive manner, leading to a high cost structure. In a number of sectors, public and private monopolies have used their market dominance to charge high prices." (NDP, 2012, p116)

High cost structures is still specifically evident in the port costs for automotive and containers as can be seen in the graph comparing total port costs across all commodities. It is therefore important for the industry to not only implement the Pricing Strategy in the short term but to also get agreement on how to align with the NDP and to reduce the imbalance between these specific commodities and global equivalents. This is imperative for the automotive industry to remain and improve its global competitiveness.



Source: *SA Ports Regulator Global Port Pricing Comparator Study 2014/15*

Coastwise and Transhipment RoRo Cargo Dues

In recent years there has been increasing interest within the industry to explore the coastal shipping, with select stakeholders going as far as participating in ad hoc trials. Under the right circumstances, Short Sea Shipping is considered to represent an opportunity to service local retail markets and potentially African export markets, in line with Government and Transnet's objectives in terms of Operation Phakisa and the MDS respectively.

At present the published tariff book only has Coastwise and Transhipment Cargo Dues rates relating to Break-bulk/Bulk and Containerised cargo. May we therefore request clarity from the NPA specifically relating to RoRo equivalents. Furthermore may we ask that the Regulator consider incentivisation of such Coastal/Transhipment rates in order to encourage the introduction of what would be additional volumes that do not currently exist within the ports system. In addition to the Phakisa incentives already in place for South African flagged vessels, favourable Cargo Dues may encourage increased localisation within the maritime supply chain.

Conclusion

The automotive industry welcomes the reduction in cargo dues relating to both container cargo as well as vehicles implemented within recent cycles. We believe it is important and in the best interests of South African manufacturers and consumers that the agreed Pricing Strategy is implemented accurately and timeously. The industry's request for consideration of a 5% decrease, in order to accelerate tariff rationalisation, is therefore submitted in this context and on the understanding that the resultant impact on other port users will be negligible and in line with national objectives in this regard.

Pricing disparities between bulk cargo tariffs and container & vehicle cargo tariffs are notable in the context of the Pricing Strategy. Furthermore, container and RoRo tariffs remain significantly higher than global comparator ports. As such, we maintain the view that multi-year negative adjustments to both Cargo Handling Types will be required to move the South African port structures closer to global best practise.

In addition to the comments relating directly to tariffs, we would like to request that the Regulator consider other proposals put forward as part of this submission. These include:

- A proposal to consider pro-rating the total ETIMC, adjusted annually, in line with the with the Authority's capital investment programme(s) for the foreseeable future bearing in mind resultant increases in operational costs arising from the CAPEX.
- A request to consider publishing an updated Pricing Strategy on an annual basis. This would enable the Regulator to update the allocation attributable to each port user as well as the forecast end state tariffs, taking into account the actual tariffs, volumes and revenues in each financial year.
- A request for clarity from the Regulator &/or NPA specifically relating to RoRo Transhipment rates.
- A consideration for incentivisation of RoRo Transhipment rates in order to encourage the introduction of what would be additional volumes that do not currently exist within the ports system.