THE PORTS REGULATOR OF SOUTH AFRICA
The Marine, Gardiner Street
Durban

13 December 2012

SUBMISSION TO THE NATIONAL PORTS REGULATOR RE TARIFF PROPOSAL BY THE TRANSNET NATIONAL PORTS AUTHORITY FOR 2013-14

1. PREAMBLE

Sasol is a South African registered company with significant international business activities, but with the majority of its revenue generated from South African operations. These operations are diverse, and comprise both significant import as well as export-dependent businesses.

Sasol annually exports approximately 3 million tons (Mt) of coal, 1 million Mt of bulk liquid chemicals, and approximately 500 000 Mt of containerised chemicals, and imports about 3.5 million Mt of crude oil, clean petroleum products and other dry bulk cargoes. We are a lessee of the Transnet National Ports Authority (hereafter TNPA) property through the leases of the "Natcos" facilities in Durban for the storage of crude oil, petrol and diesel. Sasol holds a 63.64% interest in Natcos.

As a company with significant international business activities, Sasol is extremely dependant on the ports of South Africa, especially Richards Bay and Durban. The efficient functioning of our ports, as well as their cost effectiveness are, and will always remain crucial elements of the long term success of Sasol and the South African economy as a whole.

Sasol has a number of contracts with several TNPA lessees who perform services in our import and export supply chains including Richards Bay Coal

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Terminals, Island View Storage, Transnet Port Terminals, Vopak, ITS and others for which we pay significant fees. Through these contracts, Sasol is a major contributor to the revenue stream of the Authority. As the charterer for bulk liquid imports and exports, the port dues and other costs of ships carrying Sasol cargoes are indirectly paid by Sasol, as recovered in freight costs or delivered product prices.

Sasol's direct, plus indirect expenditure with the Authority is therefore estimated to be about R280 million per year. This qualifies Sasol as a significant single contributor to the revenue of the Authority.

To succeed as an international competitor, as well as in growing the South African economy, we have to be additionally vigilant in containing our total logistics costs to international markets in order to remain competitive and successful in the face of international competition. Sasol however strongly supports the principle communicated by the TNPA to expand infrastructure ahead of demand, and recognises that all users should accept the fair cost associated with this.

2. THE NATIONAL PORTS AUTHORITY TARIFF APPLICATION FOR 2013-14

2.1 General

The tariff application of the Authority has been studied, together with the information shared and guidelines provided by the Regulator and the TNPA at the road show meeting in Johannesburg. Sasol will provide comments in response to the application for a general increase of 5.4% in two parts. A detailed analysis with comments on the financial and economic principles and assumptions behind the TNPA tariff application and calculations is offered in Annexure 1 to this document. Any additional, general comments on the TNPA application are incorporated in the rest of this main document.

2.2 Assumptions used to determine required rate increase for 2013-14.

Irrespective of the detailed analysis in Annexure 1, the concern expressed at the Johannesburg road show meeting regarding the logic of the Authority in forecasting its revenue from Marine business for 2013-14 is reconfirmed by Sasol. It is held that the inclusion of the R1.0 bn export rebate programme cost to the Authority (which applied to 2012-13), will NOT again be available for port users in the 2013-14 year, and should NOT be included. The indicated volume growth appears to be leaving the authority with a sufficient increase in revenue

that, on average, a decrease in tariffs for 2013-14 can be afforded. It obviously requires re-evaluation of the various core commodity clusters to assess how best to do the required redistribution of the revenue stream contributions (especially the increase for bulk commodities contribution) to achieve the appropriate revenues from each of the clusters. Sasol supports the approach for a reduction in tariff for export containers, as the change will make a useful contribution to the competitiveness of especially our commodity based products where international margins have been increasingly diminished by global market forces. As a significant exporter of coal, which leaves little room for realistic additional beneficiation (contrary to most other base minerals), we however strongly suggest that the adjustment to export cargo dues for this commodity be revised in the re-assessment of the commodity clusters. The mining and beneficiation of coal contributes significantly to job creation in the SA economy and in general leaves very limited opportunities for value addition at destination after export.

2.3 Multi-year rate determination

The arguments presented by the TNPA relating to longer term revenue certainty to be able to attract the best financing rates for investment has been considered. In principle the argument for more certainty is accepted, but Sasol is of the opinion that the process for tariff application and approval by the Regulator already represent a level of certainty re future returns for the Authority. Obtaining the lowest cost of financing investments obviously benefits ALL stakeholders in the South African ports. The principle of a multi-year rate application is therefore not necessarily dismissed, but the poor track record of the Authority in predicting its future revenues since the start of the current process, leaves industry sceptical about the ability of the authority to get it right over a number of years ahead. The principle of revenue claw-back should however still be enforced to reduce future tariffs in the case of over-recovery in any single year, irrespective of any long term tariff increase approval.

2.4 Relative cost and efficiency of the SA ports used by Sasol, compared to other global ports?

The comparison of the costs effectively paid to use our key ports must be done relative to the similar costs, but also related to the comparable efficiencies achieved at other ports typically used by our competitors to supply the same markets. For Sasol the key impacts of port inefficiencies are experienced in the impacts this has on shipping companies we employ and the subsequent decisions they make in the face of such inefficiencies. In the 2012-13 Sasol submission we reflected on the challenges we face as a result of extremely slow decision making, with specific mention of the drawn out process to establish a

second chemical berth in Richards Bay. One year later we can report that the eventual commissioning of this berth during Q1 2012 has already drastically reduced the demurrage exposure of Sasol in Richards Bay. Data over the last 6 months seems to indicate reductions in demurrage in the order of R10/Mt for Sasol alone compared to the situation during the recent 3-5 years when only 1 berth was available.

The situation in Durban however remains one of significant negative impact due to insufficient berth maintenance and the consequential removal of 50% of the chemical berthing capacity for repairs (berth IV5). This has dragged on already since the first half of 2009, with potentially another 18 months before the situation will hopefully be normalised again. These unacceptable inefficiencies in the way the TNPA executes its mandates under the Port Act remains a grave concern and continues to add between R7m and R9m of demurrage costs per year to our bulk Supply Chains through Durban. A more acceptable level of demurrage compared to global standards would be ~30% of this figure.

The Authority has therefore, in areas relevant to our business, in many respects failed in its duties to ensure “effective and productive ports” as required by the Act as we inevitably end up paying for such inefficiencies and delays in execution. Sasol is likely to continue facing the alarming levels of congestion (and subsequent demurrage) for bulk liquid vessels at Island View berths in Durban for at least another 18 months.

CONCLUSION

The importance of fully functional, efficient and cost effective ports to the South African economy cannot be under-estimated, and is essential for a strong export economy. This requires our ports to remain competitive in a sustainable way, compared to rival ports through which other global exporters move their products.

Sasol is concerned that the methodology and assumptions used in justifying rate increases have some serious flaws, there is a risk that the allowed increases in costs will be absorbed by port users, this will have a negative effect, especially given the realities of the competitive international market forces we are up against.

In conclusion, the request of the Authority for an increase of 5.4% average is considered inappropriate given the growth in volumes and related revenues. Should the concerns re: the R1.0 bn export rebate mistake in the calculations be

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confirmed after thorough analysis, the Regulator is requested to seriously consider approving no tariff increase for the 2013-14 year on average. This will also create an opportunity for the correction of any undue cross subsidisation between commodity clusters (especially to be tested for coal), to be introduced over more than one year.

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ANNEXURE 1: Sasol Group Corporate Finance Assessment of the Economic and Financial principles on the TNPA's tariff application

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TRANSNET NATIONAL PORTS AUTHORITY TARIFF APPLICATION FOR FINANCIAL YEAR 2013/2014

1. BACKGROUND

Group Corporate Finance ("GCF") was approached by the business to provide comments on the components of the methodology followed by the Transnet National Ports Authority, a division of Transnet SOC Limited ("the Authority") in determining the tariffs for services and facilities offered by the Authority.

Set out below are the comments and findings by GCF regarding the various components of the tariff calculations.

2. REVENUE REQUIREMENT

2.1 General (p6)

The guidelines could not be found on the webpage of the Authority and as such GCF could not assess whether;

The calculation of the revenue requirement is in accordance with the published guidelines, nor

- Due to the fact that a clawback calculation and Excessive Tariff Increase Margin Credit is provided for in the calculation, the consistency in calculation with prior periods is important in order to protect the interests of all parties.

2.2 Depreciation (p6)

The inclusion of depreciation as a separate component of the Revenue Requirement calculation seems flawed.

- In the *Conceptual Framework for Financial Reporting* an asset is defined as a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

- In International Accounting Standard 16, *Property, Plant & Equipment,* the carrying amount of an asset is defined as the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses; and

- Depreciation is defined as the systematic allocation of the depreciable amount of an asset over its useful life

- The Carrying amount of the Regulatory Asset Base (net of depreciation) is therefore a reflection of the future economic benefit which should flow to the owner thereof and the subsequent inclusion of depreciation seems to over inflate the Revenue Requirement of the Authority.

2.3 Multi-year basis inflation (p7)

The Authority indicates that is mindful of Transnet's commitment to reducing the cost of doing business in South Africa.

- The commitment of sustaining 8.5% per annum tariff adjustments (CPI+3%) over the remaining years of the Transnet MDS seems contradictory to this commitment

- The aggressive CAPEX programme should result in a growth in Revenue mainly through **volumes** and not through **price** increases and we believe that a commitment to tariff adjustments closer to CPI is in the best interest of the South African economy

2.4 Components of the WACC rate to be amended (p67 onwards)

2.4.1 Risk free rate

In practice, the return on sovereign bonds in a country where a business is evaluated is regarded as zero risk. TNPA's application indicates that the R186 SA Government bonds should be utilised to determine a risk-free rate to be applied in the WACC calculation. The yields on the R186 proposed by TNPA are in the region of 8.36% rising to 8.62% from 2013/14 to 2018/19, although the yields on this bond was 7.31% average yield as per Bloomberg data in September 2012. We therefore considered the calculated yield to be excessive based on the TNPA applications.

In practice, investors in listed securities tend to utilise the sovereign bond in South Africa which is assumed to resemble the risk free rate of return and the period over which a rational investor will review the returns offered by an

investment is widely regarded to be 10 years (or closest proximity thereto). As such we recommend the R208, which expires in March 2021, be used as an appropriate basis for the risk free rate to be utilised in the WACC calculation. The average yields for the R208 is in the region of 6.61% as per Bloomberg data in September 2012.

The R186 used by TNPA produces a higher yield than the R208 and results in a higher WACC rate.

2.4.2 Market risk premium ("MRP")

The MRP has been determined using the DMS data (obtained from the data calculated by Professors Dimson, Marsh and Staunton (DMS), and published annually in the Credit Suisse Global Investment Returns Sourcebook). This data goes back to early 1900s and represents historical data that reflect a different environment for South Africa from an investment perspective that was considerably riskier for investors. A shorter period of 20 to 25 years is considered a more appropriate basis to determine the MRP.

Based on the published MRP data since 1985, an average MRP of 5.43% was calculated for the JSE and this is in line with the proposal contained in the PricewaterhouseCoopers Valuation Methodology Survey. We therefore proposed that the market risk premium be adjusted from 6.3% down to 5.43%. The 6.23% utilised in the WACC calculation of the Authority is therefore considered excessive compared to a realistic range over the 20 to 25 year period.

2.4.3 Equity beta

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. TNPA's application suggests that the equity beta of JSE top 40 index should be used as the beta for TNPA's WACC rate. In order to assess the suitability of this measure, we analysed the constituents of the JSE top 40 index and these consist mainly of resource companies, financial services and other large industrial companies. This is a deviation from the normal practice that would require the use of comparative companies in the same industry.

All these companies are exposed to a greater number of financial and other risk factors, creating a larger amount of volatility in the returns, as compared to what a port would be exposed to.

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We believe that using the JSE top 40 companies as a proxy to determine the beta is flawed as TNPA's revenue will be exposed to much less volatility and further will be recoverable in a following period should an over/ under recovery occur in the preceding period.

As a result we believe that an equity beta closer to 1 (which is a reflection of the entire market's return) is more appropriate.

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