THE PORTS REGULATOR OF SOUTH AFRICA

The Marine, Gardiner Street

Durban

4 November 2013

SUBMISSION TO THE PORTS REGULATOR of SA RE TARIFF PROPOSAL BY THE TRANSNET NATIONAL PORTS AUTHORITY FOR 2014-15

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 3.3 million tons (Mt) of coal, 1 million Mt of bulk liquid chemicals, and approximately 535 000 Mt of containerised chemicals, and imports about 3.5 million Mt of crude oil, clean petroleum products and other dry bulk cargos. We are a lessee of the Transnet National Ports Authority (hereafter "the Authority") 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 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 of revenue to the revenue of the Authority.

To succeed as an international competitor, as well as in growing the South African economy, Sasol has to be additionally vigilant in containing total logistics costs to international markets in order to remain competitive and successful in the face of increasingly fierce 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

Sasol would like to applaud the Ports Regulator on the pro-active involvement and re implementation of the Regulatory Manual as a basis for the TNPA's tariff application for FY 14/15.

The tariff application of the Authority has been studied, together with the information shared, Regulatory Manual 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 8.5% 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 covered in the rest of this main document.

Sasol is in agreement with the fundamental argument to base the required rate increase on required revenue, however Sasol still has a few concerns relating to the resultant values being used e.g. opening net book value, required capital as part of the RAB calculation, etc.

2.2 Assumptions used to determine required rate increase for 2014-15.

Irrespective of the detailed analysis in Annexure 1, the following are general comments and concerns:

2.2.1 The approach where the value of land/ property assets are continuously appreciated with by inflation in the Net Book Value, in our opinion requires further scrutiny. Land requires very limited on-going investment of capital by the Authority, and the effective value of current land included in the book value, which is escalated annually, likely overstates the revenue requirement.

The likely future land acquisitions needed for the port expansion plans obviously need to be accounted for as part of future capital expenditure, and provision for such land acquisitions would have to be accounted for in setting an appropriate return for the Authority.

2.2.2 The track record of annually achieving well below the budgeted CAPEX for the upcoming year also in our opinion overstates the required revenue and resultant tariff increase required. (Also see Annexure 1)

2.3 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 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.

Unfortunately, the issue of Port efficiency continues to be a sensitive point for Sasol. The slow decision making process of the TNPA and execution of maintenance and upgrades are concerns that were raised by Sasol in the past few years. The situation in Durban remains one of significant negative impact due to insufficient berth maintenance and the consequential removal of 50% of the chemical berthing capacity for repairs (IV5). This has dragged on already since the first half of 2009, with little clarity on when the situation will permanently change for the better. These unacceptable inefficiencies in the way the TNPA executes its mandate under the Port Act remains a grave concern and continues to add between R7 million and R9 million in demurrage costs per year to Sasol's bulk liquid Supply Chains through Durban.

In terms of Sasol's crude oil imports; there is a strong perception that the wharfage/cargo- dues costs charged does not reflect the service levels received from the TNPA. These costs are being forwarded to the South African consumer and therefore also have a longer term negative impact on the economy.

Despite some encouraging signs in driving future efficiency improvements, the Authority has, in Sasol's opinion, largely failed in its duties to consistently 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.

Sasol would like to comment on the TNPA's implementation of the Terminal Operator Performance Standard (TOPS), which is viewed as a positive step in the right direction to improve Port efficiencies.

2.4 Multi-year rate determination

The long term strategy of the Ports Regulator to implement a Tariff Methodology as basis for future tariff applications by the TNPA is viewed as a constructive approach by Sasol.

The TNPA's strategic intent to implement a multi-year tariff adjustment principle which will attribute to longer term revenue certainty, and thus also attract the best financing rates, is in principle not dismissed by Sasol. However, the poor track record of TNPA to predict its future revenues as well as CAPEX, which is the basis for the required rate adjustments, makes the industry sceptical about future tariff adjustments and the TNPA's ability to accurately implement and execute project plans. To implement above inflationary increases consistently will have a detrimental effect on the competitiveness of South African Ports and South Africa's economic growth.

3. 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 fundamental basis and assumptions used in justifying rate increases still has some flaws and continues to be inflated by some margin. The risk is that the industry will have to absorb higher effective Port costs, resulting in South Africa's Ports being even more uncompetitive. Exporters increasingly have to face the pressure of international market forces in which the industry needs to compete.

In conclusion, the request of the Authority for an increase of 8.5% is considered inappropriate. The Regulator is requested to seriously consider approving a tariff increase no more than inflation for the 2014-15 year on average.

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2013-11-04

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

29 October 2013

TRANSNET NATIONAL PORTS AUTHORITY TARIFF APPLICATION FOR FINANCIAL YEAR 2014/2015

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 as set out in the Tariff Application for Financial Year 2014/2015 ("Tariff Application"):

REVENUE REQUIREMENT

Revenue requirement increase in excess of inflation (p8 onwards)

- The Authority indicates that it is mindful of Transnet's commitment to reducing the cost of doing business in South Africa. The following seems contradictory to this commitment;
    - The proposed tariff adjustment of 8.5% for 2014/15 (CPI+3%) and indicative tariff adjustments of between 7.0% and 12.89% in the years beyond 2014/15; and
    - In March 2012, President Jacob Zuma announced that "the Port Regulator and Transnet had agreed on a R1 billion rebate, which would result in exporters of manufactured goods receiving a significant decrease in port charges. I am pleased to announce that the rebate will come into effect on the 1st of April 2012".

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

Lastly, the Port Regulator's study into comparative pricing of South Africa's port charges show that the Authority's prices are significantly above average tariffs and the above increase in tariffs will continue to negatively impact the economy.

Estimated Capital expenditure (p12)

- Each year, estimated capital expenditure and depreciation is added to the closing balance for the previous year to arrive at an updated closing balance for the current year. Historically however, the Authority has consistently underspent on capital expenditure as indicated in Table 1 below. As a result of this methodology, the Regulatory Asset Base ("RAB") on which the Revenue Requirement is based has consistently been overstated before applying the claw-back in subsequent years. This methodology effectively results in additional working capital to the Authority on which no return is provided to the funders thereof and results in the economy being negatively affected from a competitive perspective as the revenue has been [significantly overstated]. The overstated capital expenditure historically is significant as indicated below:

Table 1 - Actual versus budgeted capital expenditure reported

Year	Budget (R'm)	Actual (R'm)	% underspent
12/13	2,278	1,750	23.18%
13/14	5,326	2,219	58.34%
14/15	3,317		

- A significant proportion of capital expenditure relates to amounts spent on Port Facilities, which takes more than one financial period to be brought into use. Therefore revenue is generated by the Authority on facilities not yet offered to customers and for their benefit. Normal business practice requires the facilities to be available before one should be able to charge for these.

Depreciation (p13)

- 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.

Components of the WACC rate to be amended (p14 onwards)

Risk free rate

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 consider the R208, which expires in March 2021, be used as an appropriate basis for the risk free rate in the WACC calculation. The average yields for the R208 over the same 5 year period as applied by the Authority is in the region of 8.06% as per Bloomberg.

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

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 1900's and represents historical data that reflects 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, as it reflects the new realities in the South African economy.

Based on published MRP data since 1985, an average MRP of 6.25% was calculated for the JSE and this is in line with the proposal contained in the PricewaterhouseCoopers Valuation Methodology Survey and approach supported by National Energy Regulator of South Africa (NERSA). We therefore propose that the market risk premium be adjusted from 7.10% down to 6.25%. The 7.10% utilised in the WACC calculation of the Authority is therefore considered excessive compared to a realistic range over the 20 to 25 year period.

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