

# ANNEXURE "MSM 37"

Transnet SOC Ltd  
Registration  
Number  
1990/000960/30

Carlton Centre  
150 Commissioner  
Str. Johannesburg  
2001

P.O. Box 72501  
Parkview  
South Africa, 2122  
T +27 11 308 2250  
F +27 11 308 1269



**MEMORANDUM**

www.transnet.net

**TO :** Transnet Acquisitions and Disposals Committee  
**FROM :** Shyabonga Gama, Group Chief Executive Officer  
**SUBJECT :** **COST SAVINGS AND EFFICIENCY FOR SUPPLY CHAIN MANAGEMENT (SCM) AND REVENUE ENHANCEMENT PROPOSALS**

**PURPOSE:**

1. The purpose of this memorandum is for the Acquisitions and Disposals Committee to recommend that the Board:
  - Approve the appointment of consultants for:
    - The Cost Savings and Efficiency Proposal for ISCM from Nkonki Incorporated which was approved as a permitted Non-Audit service by the Audit Committee.
    - The Iron ore and Coal revenue enhancement program proposals for Transnet Commercial from Nkonki Incorporated which was approved as a permitted Non-Audit service by the Audit Committee.
  - Delegate authority to the GCE to sign all documentation including the contract documentation.

**BACKGROUND - ISCM COST SAVINGS AND EFFICIENCY:**

2. The Group Leadership Team (GLT) has raised concerns that the current SCM practices are bureaucratic, extremely complex, contains restrictive red tape which is administratively overburdening, and are not supporting business to be responsive and effective in both the short and long term.
3. GLT requires that the current SCM practices be reshaped and enhanced in order to ensure that SCM is more responsive, agile, and automated to increase efficiencies, create improved economic value with the ultimate aim of reducing the cost of doing business with Transnet.
4. GLT also requires SCM function to develop and/or enhance key focus areas with a view to identifying key initiatives that can be developed and implemented to improve "EBITDA", whilst still maintaining compliance to the regulatory and governance requirements of Transnet. These initiatives must include the development of Strategic Supplier Partnerships, the development of category strategies and the setting up of

- Contract Candidates
- Potential Contract Leakage
- Retrospective Spend
- Duplicate Payments
- Outside Procurement spend
- Inventory Optimisation

ii) Identify the improvement areas of the SCM practices, and to assist in the co-development, of the required tools, templates, and related processes and systems to increase efficiencies and effectiveness across the following areas:

- Strategic Supplier Relationships
- Demand Planning
- Cost Savings Strategies
- Current Governance Structures and SCM regulatory Environment

11. The proposal submitted encompasses:

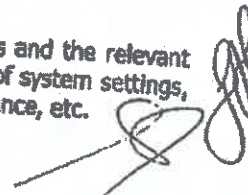
- An Initial analysis to establish potential cost savings initiatives and levers.
- Enhancement of the current management information reporting system for use by executives, senior management and any other specified business resources within the supply chain environment to promote visibility of Transnet's strategic cost savings objectives and initiatives.
- The required roadmaps and action steps to realise the identified initiatives
- Monitoring of progress on approved improvement campaigns.
- The requisite resource capability to deliver the identified action plans, if required.

12. Cost Savings scope

- This initiative is aimed at achieving savings for Transnet which will directly increase Transnet's EBITDA and NPAT.
- The development and implementation of a Cost Savings plan for Transnet which would typically encompass the following key activities:
  - Spend Analysis.
  - Target Setting.
  - Quick Hit Opportunities Execution.
  - Supplier Relationship Opportunities Execution.
  - Strategic Sourcing Opportunities Execution.
  - Qualitative Enhancement of Supply Chain Optimisation.
  - Underlying work breakdown structures and attendant reporting for each saving initiative.
  - Continuous Improvement and monitoring.
  - Cash Interest Cover
  - Knowledge and Skills transfer for sustainable Qualitative Enhancement of Supply Chain Optimisation

• In order to capture this opportunity and make it sustainable:

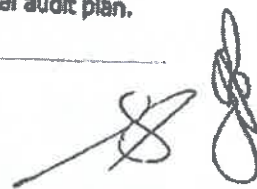
- A twenty four month programme is proposed, to enable the cost savings identified and to be approved by Transnet.
- A strong focus will be on the underlying levers, processes and the relevant compliance, e.g., capability building and training, change of system settings, set up of a continuous tracking function to monitor compliance, etc.



15. The project will commence one week after the approval of the proposal.
16. The longer contract period will allow for the transfer of skill to Transnet and its employees.
17. The assignment falls within the guidelines for the provision of non-audit services by TIA as:
- It is aimed to add value by providing savings to Transnet and thereby increase EBITDA and NPAT;
  - It is also aimed at enhancing the governance and control environment; and
  - It does not distract TIA from effective execution of the annual audit plan.

**DISCUSSION - - IRON ORE AND REVENUE ENHANCEMENT:**

18. Transnet requires initiatives that will enhance the revenues earned from the Iron Ore and Coal Businesses.
- Performing the equity balancing (verification and support) for the RBCT in order to assure revenue and integrity on the allocations and to monitor and manage take or pay contracts or penalties. This is required to be performed on a weekly basis.
  - Benchmarking on Iron ore rail transport.
  - Specialist support in the revising of the Iron Ore take or pay agreement
  - Setup the customer nerve centre which will be setup to ensure contract management compliance revenue management and new customer on boarding.
19. Currently Group Commercial does not have the necessary capability and resources internally to complete the above required initiatives and therefore seeks assistance from an external service provider.
20. Nkonki has submitted proposals to assist management with the requirements listed above.
21. Nkonki has been preferred to perform this project due to the following:
- They have institutional knowledge of Transnet environment through their TIA engagement;
  - The use of Nkonki through the TIA contract allows Transnet to be provided with a range of skilled resources with the relevant expertise and industry knowledge at a blended rate of R938 which is far below the market price.
22. The longer contract period will allow for the transfer of skill to Transnet and its employees.
23. The assignment falls within the guidelines for the provision of non-audit services by TIA as:
- It is aimed to add value by enhancing iron ore and coal revenues to Transnet and thereby increase EBITDA and NPAT;
  - It is also aimed at enhancing the governance and control environment; and
  - It does not distract TIA from effective execution of the annual audit plan.



31..1.2. In essence the cost saving initiative of the project is self-funding (i.e. determined on risk), and is based on a gain share methodology. Nkonki will thus be rewarded according to an implementation milestone/s, to be agreed with Transnet. The proposed gain share would be based on 12% to 14% of OPEX savings delivered and 8% to 10% of CAPEX savings delivered and will be subject to the final negotiations with Nkonki. The initial estimation is that the indicative savings that could be achieved out of the activities in paragraph 10i above could range between R1,1 billion and R2,6 billion. This would place the possible gain share fee at approximately R260 million if the savings are achieved. Further savings could be extracted through the other initiatives as described in paragraph 12 and 13 above.

31..1.3. The cost of the cost savings initiatives will be directly funded from the saving delivered based on the gain share methodology.

31..1.4. On the revenue enhancement program the revenue tariffs work will be outcome based and the cost (on a gain share basis of 12% to 14%) will be self-funding through the increased tariff that will be finalised with the customers on the take or pay agreements and will be subject to the final negotiations with Nkonki. There is possibility to get an increased tariff on iron ore as one of the contracts is approximately 27% below the required average tariff. This could provide additional annual revenue of R1,065 billion on approximately 35 million tons annual volume. The gain share on this would be approximately R127 million. Further revenues can be enhanced through the other tariff initiatives.

32. Fee based/ fixed fee:

32..1.1. The fee based work will require a guarantee to be in place that will ensure that any fees paid will be able to be recovered if no equivalent savings/ additional revenue are produced and realised.

32..1.2. The improvements to the efficiency and effectiveness of the SCM processes as well as the Iron ore and Coal revenue enhancement programs (excluding the tariff work) will be based on a time and material basis. It is expected that the following resources will be required at the rates stipulated below, the expected fees for the fixed services are stated below and will not be exceeded but the final fees and rates will be subject to the final negotiation and contract:


| Project             | Full Time Resources | Rate per hour | Duration  | Expected total Fixed cost on time and material basis |
|---------------------|---------------------|---------------|---|--|
| ISCM                | 50                  | R 938         | 18 to 24 months   | R100 million   |
| Revenue enhancement | 25                  | R 938         | Goal 36 Months<br>Iron ore and customer nerve centre<br>6 - 12 months | R50 million  |
| <b>Total</b>        |                     |               |   | <b>R150 million</b>                                  |

32..1.3. We anticipate that the cost for efficiency and process improvements as projected above will also be recovered through the cost savings generated by this program as well as the reduced monthly costs that Transnet is currently incurring on its current procurement analytic solution of approximately R50 million for the 24 month period.

**RECOMMENDATION:**


38. The Acquisitions and Disposals Committee to recommend that the Board:
- Approve the appointment of consultants for:
    - The Cost Savings and Efficiency Proposal for iSCM from Nkonki Incorporated which was approved as a permitted Non-Audit service by the Audit Committee.
    - The Iron ore and Coal revenue enhancement program proposals for Transnet Commercial from Nkonki Incorporated which was approved as a permitted Non-Audit service by the Audit Committee.
  - Delegate authority to the GCE to sign all documentation including the contract documentation.

Recommended By




Garry Pita  
Group Chief Financial officer  
Date 6/2/17

Recommended By



Ndiphwe Silinga  
Chief Legal Counsel  
Date 06/02/2017

Recommended By



Siyabonga Gama  
Group Chief Executive  
Date 2017; 02.07

Resolution Not For Attention

1. CONSTITUTION OF MEETING
- 1.1 Present  
 Mr SD Shere  
 Mr BI Gumb  
 Ms LC Mabebe  
 Mr ZA Ngqobe
- Chairperson  
 Member (Group Chief Executive)  
 Member
- 1.2 In Attendance  
 Mr GA Moko  
 Mr AJ Danyelle  
 Mr N. Sinye  
 Mr Z. Thomas  
 Mr L. Besemont  
 Ms D. Nkomo
- Chief Financial Officer  
 General Manager, Office of the Group Chief Executive  
 Chief Legal Counsel  
 Chief Supply Chain Officer  
 Company Secretary  
 Deputy Group Company Secretary
- 1.3 Partial Attendance  
 Mr R. Ngidi  
 Ms S. Madike  
 Ms MA Mopeli  
 Ms L. Sanye  
 Mr K. Reddy  
 Mr M. Shongwa
- Chief Executive, Transnet Freight Rail  
 Chief Procurement Officer, Transnet Freight Rail  
 Group Chief Information Officer  
 Chief Information Officer, Transnet Freight Rail  
 Chief Capital Officer  
 General Manager, Capacity Development Services, Group Capital
- 1.4 Welcome and Signing of Attendance Register  
 1.4.1 The Chairperson welcomed all members and attendees present, and during notes that there was a quorum, declared the meeting duly constituted. The Attendance Register was circulated for signature.
- 1.4.2 The Chairperson noted that the GCE was delayed from a prior meeting. The Chairperson requested that the meeting be adjourned on arrival of the GCE for a holding meeting between the Group Chief Executive, Chief Financial Officer and the Chairperson.
- 1.5 Adoption of Agenda
- 1.5.1 The Committee noted the additional agenda items 5.8, and that agenda item 5.1 is tabled for noting purposes, so it was approved at the Board meeting held on 22 January 2017. The Agenda was adopted subject to those amendments.
- 2 SAFETY BRIEFING AND EVACUATION PROCEDURE
- 2.1 The safety and evacuation procedures for the 4th Floor were conducted through video review.
- 3 DECLARATION OF INTERESTS
- 3.1 The Declaration of Interest Register was circulated to all members and attendees for signature.
- 4 LIST OF SUPPLY CHAIN AGREEMENTS
- 4.1 The Committee noted the list of Supply Chain Agreements.
- 5 MATTERS FOR DISCUSSION/APPROVAL
- The Chairperson requested that items 5.1, 5.2, 5.3, 5.4, 5.5, 5.6, 5.7, 5.8, 5.9, 6.1, 6.2, 6.3, 6.4, 7, 8, 9, 10, 11, 12 and 13 be dealt with first. These minutes reflect the order of the meeting.

Resolution Not For Attention

- 5.8 Cost Savings and Efficiency for Supply Chain Management (SCM) and Revenue Enhancement Proposals
- 5.8.1 Management took the Committee through the slides as contained in the meeting pack. The submission was taken as read. The purpose of the submission was to request the Committee to recommend that the Board approve the appointment of Alstom Incorporated for consultancy services for:
- Cost Savings and Efficiency Proposal for Supply Chain Management (SCM) which was approved as a permitted Non-Audit service by the Audit Committee;
  - The loss and cost revenue enhancement program proposals for the Company's Commercial business, which was approved as a permitted Non-Audit service by the Audit Committee; and
  - To deliver advisory to the Group Chief Executive to align self documentation including the contract between Transnet and Alstom Incorporated.
- 5.8.2 The Committee noted that the current SCM practices are cumbersome, complex, contain repetitive red tape, which is administratively cumbersome, and are not supporting business to be responsive and effective in both the short and long term.
- 5.8.3 Management required reshaping and enhancement of the existing SCM practices to ensure that they are more responsive, agile and automated to increase productivity, create improved commercial value with the objective of reducing the cost of doing business with the Company. Management further requested the SCM function to develop a robust and efficient key focus areas in order to identify key initiatives that can be implemented to improve EBITDA. These initiatives must, however, remain aligned to the regulatory and governance requirements of the Company. This initiative would include the development of Strategic Supply Forecasting, development of capacity strategies and setting up 'SMART' teams to drive cost savings, including performance and price realizations, reviewing the processes and procedures and reducing unnecessary bureaucracy thus achieving procurement processes to be responsible to business and to be a low business liability.
- 5.8.4 A Member requested whether the services could be capped within the Company's supply management framework and secondly, given the essential nature of the services, Management confirmed that the committee adopted authority of the Committee for approval of Commercial policies and that the cost could therefore be capped within the approved limit of the Committee. It was further stated that the Board of Directors would be informed of the decision through the executive director of the Company's Regulatory Register at the next scheduled Board meeting.
- The Committee noted that Alstom would be required to conduct a specific supply management project, namely 45% sub-contracting to BPO, BPO or BTO companies in order to drive improvement and transformation in the industry.
- 5.8.5 The Committee further noted that the business identified two categories namely a fixed fee on the hourly work and a fee based on gain share/contingency. The gain share will be paid at the agreed rate on savings under suboptimal revenue, actually delivered. The fixed-fee arrangement will be paid only when the required or reduced savings threshold amount defined from the services they have provided. The Committee noted the existing relationship with Alstom who are External Auditors of the Company. Furthermore, the Audit Committee approved three non-audit services, subject to the applicable governance process.
- The Committee approved the appointment of Alstom Incorporated for consultancy services up to a maximum cost of R500m as follows:
- Cost Savings and Efficiency Proposal for Supply Chain Management which was approved as a permitted Non-Audit service by the Audit Committee.

CONFIDENTIAL

10

Resolution Ref  
For Attention

Item covered Code Corporate enhancement program proposed for the Company Commercial which was approved as a permitted Non-right exercise by the Audit Committee

- Deleted entirely in the Group Chief Executive to sign of documentation including the 7-18-17-17-03 contract between Tireset and Global Incorporated.

CONFIDENTIAL

11

Resolution Ref  
For Attention

12 01/08/18

13 T There being no further business to conduct, the Chairperson declared the meeting closed at 14:17

*[Handwritten Signature]*  
 CHAIRPERSON  
 DATE: 2017 01 18

*[Handwritten Signature]*  
 DEPUTY GROUP COMPANY SECRETARY  
 DATE: 2017 01 18

2018 01 18 14:17

ENCLOSURE