

# ANNEXURE "MSM 9"

**Table 2**

Best and Final Offer per Board resolution including Hedging & Escalation

Adjusted for changes to:

- Escalator up to signature date (from close of tender to Nov 14)
- Add back original TE scope removed for BFO purposes
- Force adjustment to cost rate to 17 March 2014
- Batch pricing adjustment for reduction of batch size to 40% / 40%

Best and Final Offer updated for economic and other factors

Adjustments for:  
Additional TE scope

New Price including TE scope

Cost to fix escalation to end of contract  
Cost of Hedging

Estimate of Total Cost including Hedging and Escalation

The ETC above excludes the cost of any options, variations capital spares, initial spares, tools and test equipment.  
Add approximately a further 15% at least to cover this cost.

Proposed Estimated Total Cost including Hedging, Escalation, options, spares, tools and test equipment

Adjusted BFO	25,578,833,740
Escalator	9,891,528,818
TE Scope	2,162,011,255
Force	1,754,643,360
Batch	2,930,680,146
Options	2,734,042,312
<b>Total</b>	<b>38,252,038,631</b>

A	2,162,011,255	5.6%
B	1,754,643,360	4.6%
C	2,930,680,146	7.7%
D	2,734,042,312	7.1%

B 843,172,732 2.0%

40,095,211,363

E 6,725,949,492 16.8%

F 2,729,045,496 6.9%

43,824,160,859

G 4,054,773,890

47,878,934,749

### BACKWARD LOOKING ECONOMIC AND OTHER FACTORS THAT HAVE IMPACTED THE PRICE:

24. The estimates and assumptions on which the 1064 business case was based have changed substantially since approval was obtained from the Transnet Board in April 2013.
25. In addition a number of parameters have materially changed since issue of the tender, approval of the investment by the Transnet Board and the contract negotiation process. These are summarised in Table 3 below:

Table 3

	Business Case	Tender Stage	Negotiation/ Contracting Stage	% movement
Rand to the US Dollar	9.13	8.95	10.72	19.4%
Rand to the Euro	n/a	11.85	14.87	25.4%
Local CPI	n/a	100%	106.10%	6.1% *
Local Hot rolled Steel plates Index	n/a	100%	112.90%	12.9% *
Local PPI	n/a	100%	107.50%	7.5% *
China Equivalent CPI Index	n/a	100%	102.50%	2.5% **
US Equivalent CPI Index	n/a	100%	101.33%	1.3% **
Euro Equivalent CPI Index	n/a	100%	102.08%	2.1% **

\* Index movements calculated from Dec 12 to Jan 14  
 \*\* Index movements calculated from May 13 to Mar 14

#### Item C of Table 2

- a. Foreign exchange rates. The Rand has depreciated by 19.4 % against the US Dollar since the tender stage. Similarly the Rand has also depreciated by 25.4 % against the Euro over the same period. The spot rate of exchange used in the business case to calculate the base price of the locomotive was 9.13 Rand to the US Dollar, as compared to the spot exchange rate as at contract signature date of 10.72 Rand to the US Dollar, an increase of 17.4 %. This has impacted the expected price of the locomotive as per the business case and ultimately the ETC as approved by the Board.

Consequently the additional 10.3 % per C in Table 2 is reasonable.

#### Item A of Table 2

- b. Labour cost increase. The cost of labour required to build the locomotives has increased locally within South Africa and globally over this period, as indicated within the CPI/PPI indices listed in Table 3 above and as evidenced by the higher than CPI wage settlement that Transnet entered into at 8.5 % for a 2 year period. Due to the tender localisation requirements, Transnet Engineering (TE) will assemble the locomotives and consequently local labour will be utilised for the assembly.

- c. Material cost increase. A significant component of the locomotive is steel. The price of steel is impacted by the steel commodity price of which the trading currency is in

US Dollars and secondly thereby foreign exchange deterioration as well. The local Index for hot rolled steel plates has deteriorated by approximately 12.9 % since December 2012, which is indicative of the level of increase in the price of steel.

- d. Inflation. Local Producer Price Index (PPI) has increased by over 7.5 % since December 2012 thereby affecting the price of locally sourced products required for the build of the locomotives. Foreign equivalent indices also increased over this period. This together with the foreign exchange deterioration indicated above has resulted in the price of imported components for this project increasing.
- e. Statistics SA report that the headline CPI annual inflation rate in April 2014 was 6.1 %, further explained in the Business Day article "CPI breaches Reserve Bank target" dated 22 May 2014.
- f. Applying the relevant proportion of each of the labour, material and other input costs which make up the basket of items required for the manufacture of the locomotives, would result in the net increase in the locomotive price of 8 %.
- g. Consequently the net impact of 8 % on the locomotive price due to the change in economic conditions as per item A of Table 2 is reasonable.

Increase in ETC for 1064 GFB Locomotives

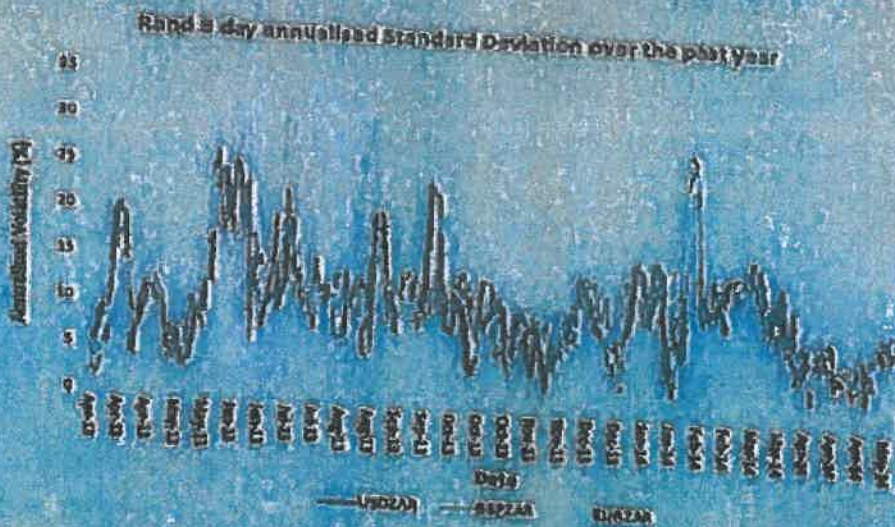


**FORWARD LOOKING ECONOMIC FACTORS AND MEASURES TO MITIGATE FINANCIAL RISK THAT HAVE IMPACTED THE PRICE:**

**Forex (Item F of Table 2)**

- 26. The Financial Risk Management Framework (FRMF) approved by the Board of Directors (BOD) does not permit Transnet accepting forex exposure on committed transactions.
- 27. The South African Reserve Bank (SARB) also does not permit SOCs to accept open exposure on foreign currency contracts.
- 28. In addition credit rating agencies and bond holders both prefer conservative risk appetites and consequently would also support fixing our forex exposure.
- 29. Sensitivities indicate that a 5% devaluation of the Rand could impact the total ETC by approximately R 3.07 billion if left unhedged.
- 30. Consequently the cost of foreign currency hedging to mitigate and protect the Company against foreign currency devaluation is an inherent cost of the transaction.
- 31. Costs related to forex are influenced by market forces which are not within management's control and therefore were not included in the ETC for the business case submission. The impact of these forex related costs would only be known once the contract was negotiated and finalised as they are based on market conditions and sentiment at the time.
- 32. The cost of fixing the forex exposure is impacted by currency volatility and time or duration of the exposure.
- 33. The recent volatility in the foreign exchange rate of on average up to between 15 & 20 % directly impacts the transaction cost as can be seen in Table 4 below:

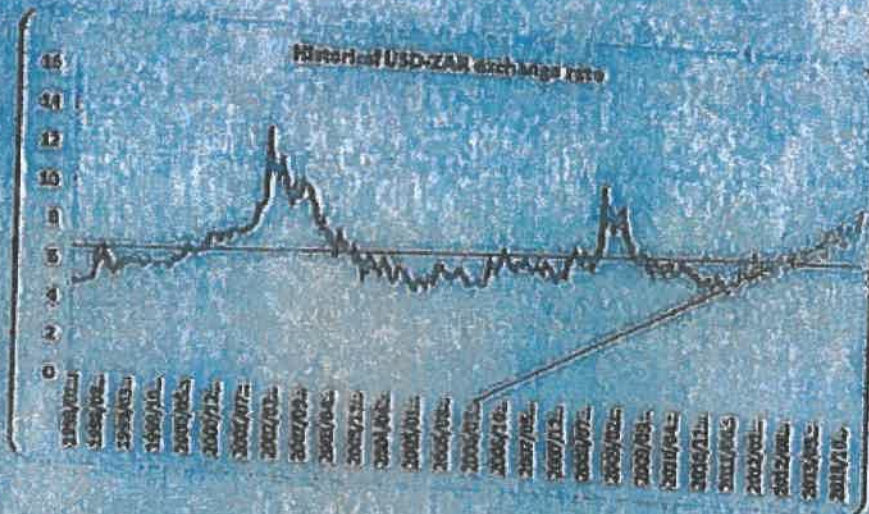
**Table 4**



Increase in ETC for 1051 GCR Locomotives

- 34. In addition the ZAR currency is one of the most volatile and fragile currencies in the world. This view is substantiated by the ZAR currency being termed as one of the "fragile five" by economists and financial markets (refer diagram below).
- 35. Business Day reported on 18 March 2014 that the Rand is in for a "Rocky ride" for the rest of the year (Refer article "Rocky Ride forecast for 'still to expensive' Rand)
- 36. The generally held consensus view is that due to the twin deficit of the RBA budget and the current account, and the weak economic outlook supports Rand devaluation in the medium to long term.

Table 5



- 37. A historical regression analysis conducted by Regiment's Capital indicates that the ZAR currency is on a trend of devaluation as indicated in Table 5 above.

*[Handwritten signature]*