

Engagement on challenges facing industry with respect to local public procurement

PRESENTATION TO THE PORTFOLIO COMMITTEE OF TRADE AND INDUSTRY

24 MARCH 2017



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PRESENTATION OVERVIEW

- Classification of the rail transport equipment sector
- Current legislative framework
- Government key goals and objectives in the rail recapitalisation programme: localisation and designation programme
- Major rail procurement programmes being rolled out
- Key Highlights and Challenges in the rail manufacturing sector
- Interventions made thus far in the rail manufacturing sector
- Outstanding policy issues to unlock further growth and development of the sector



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RAIL TRANSPORT EQUIPMENT SECTOR CLASSIFICATION

- Rail transport equipment:
 - Rail Rolling Stock (locomotives, electric multiple units, wagons, and coaches)
 - Rail Infrastructure (signalling, perway, and overhead electric transmission)
- ➔ The sectors and its various sub-sectors are vital components of modern economies as all economic sectors are dependent on the rail transport sector for movement of freight and passengers
- ➔ Rail is the most capital intensive industry and manufacturers depend on consistently sizable capital investments by state owned companies to make the manufacturing viable
- ➔ In the case of SA, employment figures for 2016 are reported under SIC 384-387 which is estimated to be just over 15 000 but the technology spillovers are enormous

CURRENT LEGISLATIVE FRAMEWORK

Designated	To date
Rail rolling stock sector	<ul style="list-style-type: none">• First issue - 16 July 2012• First amendment - 12 June 2014• Second amendment - 27 July 2016
Rail signaling and associated components	<ul style="list-style-type: none">• First issue - 27 July 2016
Steel power pylon	<ul style="list-style-type: none">• First issue - 16 July 2012• First amendment - 28 September 2015• Second amendment - 27 July 2016
Transformers, shunt reactors and associated components	<ul style="list-style-type: none">• First issue - 28 September 2015• First amendment - 25 August 2016
Electrical Cable products	<ul style="list-style-type: none">• First issue - 08 May 2013• First amendment - 27 July 2016
Steel products and components for construction	<ul style="list-style-type: none">• First issue - 01 February 2017



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INDUSTRIAL OBJECTIVE OF LOCAL CONTENT REQUIREMENTS IN THE RAIL SECTOR

Leverage public expenditure, both CAPEX and OPEX, made by SOCs (Transnet, PRASA and Gauteng Management Agency) to:

- Develop and enhance local manufacturing capacity and capabilities
- Support industrial innovation and technological developments
- Create employment and sustain jobs
- Boost exports and ensure suppliers are integrated into OEMs global value chains
- Support broader economic empowerment through the creation of black industrialists



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CURRENT MAJOR RAIL RECAPITALISATION PROGRAMMES BEING ROLLED OUT

Transnet Procurement Programme:

- 1064 locomotive programme by Transnet Freight Rail concluded with 4 OEMs in 2014:
 - 359 Electric locomotive, Class 22E by China South Rail (CSR)
 - 240 Electric locomotives, Class 23E by Bombardier Transportation
 - 233 Diesel Locomotive, Class 44 by General Electric (GESAT)
 - 232 Diesel Locomotive Class 45 by China North Rail (CNR)
- ➔ All 4 OEMs have to adhere to the requirements of designation: 55% local content for diesel locomotives and 60% local content for electric locomotive
- Maintenance of the existing fleet
- Wagon built-programme and maintenance



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CURRENT MAJOR RAIL RECAPITALISATION PROGRAMMES BEING ROLLED OUT

PRASA

- 3600 coaches built programme: in 2013, PRASA signed a R51 billion contract with the Gibela Consortium for supply of 3600 coaches over 10 years. The contracts embeds more than 65% local content to be achieved over the contract lifespan.
- Maintenance of the existing fleet
- Re-signalling projects
- Stations modernisation programmes

Gauteng Management Agency

- Expansion of the Gautrain programme: 48 EMUs currently being procured
- Feasibility studies underway for the network expansion



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KEY HIGHLIGHTS IN THE RAIL MANUFACTURING SECTOR

- Following the inception of the current contracts, over 50 companies in the sector are benefiting. Some of the key contracts signed to-date include amongst others:

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| <ul style="list-style-type: none">• Transnet Engineering will be a major role in assembly• Scaw Metals for couplers and cast wheels• Swasap for wheel axles• DCD rolling stock for the fabrication of car body• Knorr Bremse for supply of braking system• Timken for the bearings• ABB for traction transformer• Howden for motor bowlers• Penbro Kelnick for supply of braking resistors• Booyco for HVAC system• First National Battery on Train lighting batteries and battery Box• Isringhausen on driver seats• Profibre on passenger seats• ILVA on air tanks• Global Composites on ceiling & air ducts | <ul style="list-style-type: none">• Siyahamba Engineering for the windows and door systems• Wabtec for supply of braking system• Duys Engineering for fuel and water tank• Microelectrica for braking resistors and electronic parts• Supply of castings (Pefco, Guestro Foundry, Steloy, IPT, Dhuva Foundry)• Unique Engineering on pantographs• Delberg Engineering on rolling stock interior• Actom on traction motor components• Carbon Brush Technology on carbon brushes• Parsec on UHF radios• Aberdare on cables• CBI on cabling circuit braker• Radel on master Controller and others• Denel on luggage racks and ducts |
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KEY HIGHLIGHTS IN THE RAIL MANUFACTURING SECTOR

- At the back of these 1064 locomotive contracts, the industry has made significant investments to improve manufacturing capacity and capabilities across of tiers:
 - These investments include the opening of new state-of-the-art manufacturing facilities for Traction Motors and Alternators by IEC Holden in Isando. These facility is well positioned for exports markets
 - Bombardier Transportation launched their Propulsion and Control facility in Elandsfontein in July 2016. To date 2 locos are fully assembled at the Durban, a major milestone for the local industry, this will pave a way for higher local content on all future projects
 - MTU South Africa unveiled their newly upgraded workshop facilities in Cape Town in October 2016. These facilities are geared to locally assemble the diesel engines for the 232 diesel locomotives that China North Rail
 - Investments in machinery and people were also made by lower tier suppliers to meet the OEM requirements on safety and quality



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KEY CHALLENGES IN THE SECTOR

- **Application of local content requirements:** OEMs are adopting different strategies towards localisation. The approach is not always in favour of the local supply chain as the industry is not able to leverage on the learning curve in regard to the development of the first units, for example:
 - In the 1064 loco programme, 66 fully built locomotives will be imported from China (60 units) and USA (6 units), locomotives CKDs. Bombardier is the only OEM to manufacture all the locomotives in SA
 - OEMs such as GE and CSR have supplied on the Class 20, 21 and 43 locos with supplier development commitments and as such this should have paved way for greater delivery to the localisation programme
 - The first 20 trains will be manufactured in Brazil for the PRASA commuter programme. Due to the timing of the procurement, the instruction note is also not implemented in its entirety and section 9.3 of the Treasury regulations not fully utilized in areas not designated



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KEY CHALLENGES IN THE SECTOR

- **Supply chain policies of Transnet:** Policy on security of supply does not always support creation of national champions that can be nurtured to become significant global players
 - There is a need to consolidate existing capacity and create a robust supply chain based on economies of scale and scope
 - Procurement orders on the new and existing fleet need to be consolidated in order to make local investments viable
- **Delays and changes in the delivery schedules:** are negatively impacting local component and material manufacturers who are currently faced with excess capacity and limited resources to keep the companies afloat
- **High import content:** Apart from the imports of fully built locos from China & US and 20 trains from Brazil, imports on parts and components are growing
- **Black economic empowerment and black industrialists:** The rail programme has not been able to create a sizeable number of black industrialists due to market access issues such technical barriers and cost of working capital

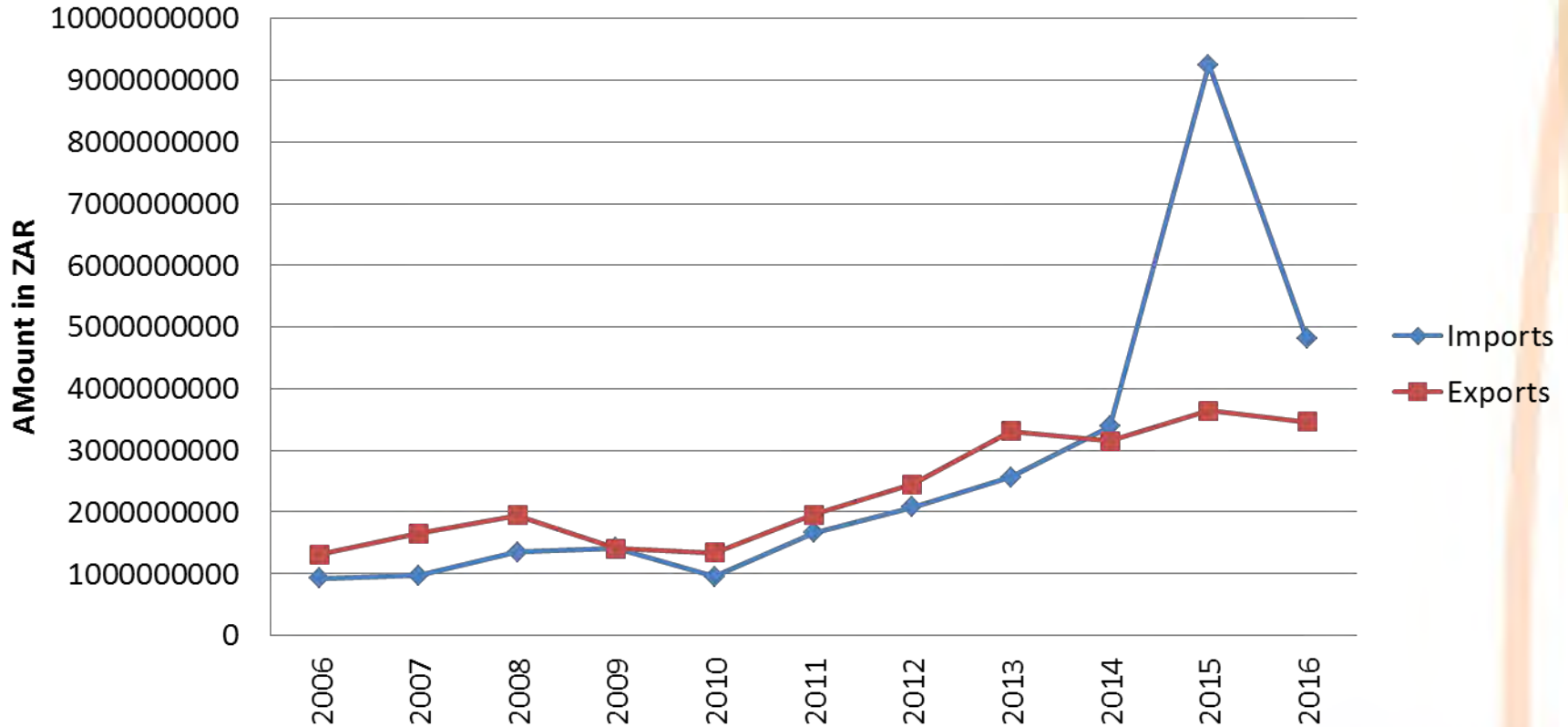


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PERFORMANCE OF THE RAIL SECTOR: TRADE ANALYSIS

SA Trade on HS86

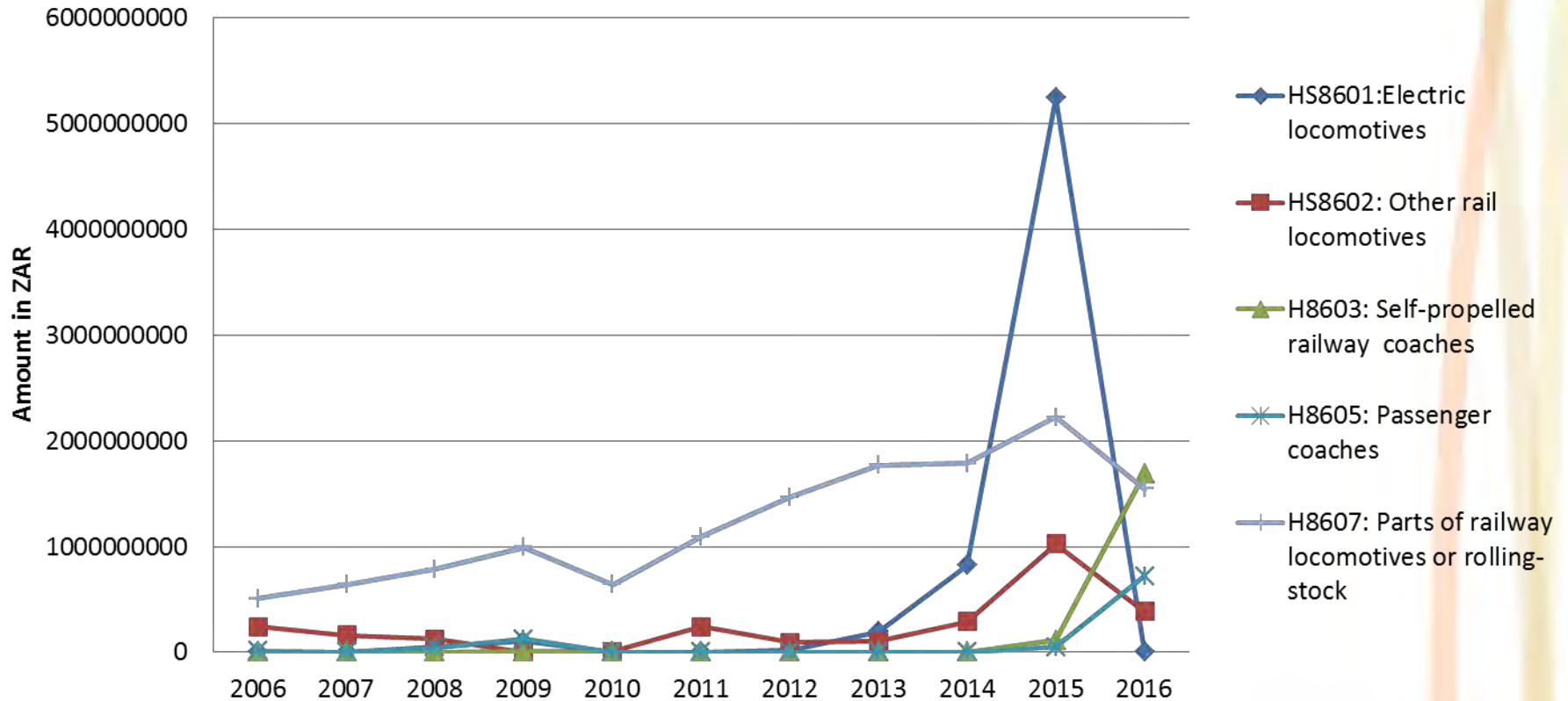


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PERFORMANCE OF THE RAIL SECTOR: TRADE ANALYSIS

H86 import from the rest of the world



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INTERVENTIONS MADE THUS FAR

- Various companies in the supply chain have been assisted under the MCEP; 12i tax allowance and IDC funding programmes
- On-going supply-side support provided under the Technology Localisation and Implementation Unit (TLIU) and National Foundry Programme
- On-going policy dialogue with Transnet, PRASA and GMA to embed the localisation imperatives into their procurements as well as to address the challenges raised above
- On-going participation in key industry forums to better comprehend their supply challenges and to improve our policy support instruments
- Recently held a DTI-DPE Ministerial Bilateral to forge a common understanding and develop appropriate support mechanisms to deepen government's industrialisation efforts



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OUTSTANDING POLICY ISSUES

- Localisation/Designations – verification, non-compliance and how to effectively deal with non-complying OEMs and suppliers
- Industrial finance – further Economic Support Packages need to be developed and deployed to unlock private-sector investments, enhance the Black Industrialist programme and catalyse industrialisation
- Significant opportunities exist to improve localisation and supplier development processes within procurement programmes



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