Dear Sirs,

We are preparing an article in which Regiments Capital together with its successor at Transnet, Trillian, stand accused of being party to the "capture" of Transnet, with the assistance of senior executives at the State Owned Enterprise.

Please come back to us with your responses by no later than 4pm on Monday, 12 September 2016.

We reflect below some of our preliminary views, together with questions for you to answer, but please feel free to comment on or correct any of the assertions.

Regiments & Trillian appear to have milked Transnet of as much as R1-billion for advisory services that insiders say included payments that were untoward, unnecessary and massively inflated.

In an extraordinary display of corporate sleight of hand, the companies were assisted to parlay what was originally a R10m slice of a Transnet contract - that they didn't even bid for - into work worth more than R600 million - and perhaps as much as R1 billion.

This happened without open tenders, in defiance of SCM rules and in a fashion that suggests an untoward relationship between Regiments & Trillian (or individuals connected to Regiments or Trillian) and decision-makers at Transnet.

These are not just opinions: they are backed up by hard evidence, including documents and sources whose concerns greatly amplify the concerns expressed by FutureGrowth.

The companies - Regiments and Trillian - got a free ride into Transnet via a 2012 contract awarded to a consortium led by global management consultants McKinsey.

McKinsey bid to act as transaction advisors for for Transnets acquisition of 1064 locomotives (valued at R55 billion) in a consortium with Nedbank and McKinsey's long-time empowerment partner, Letsema.

A month after the contract was awarded Transnet came up with a claimed confllct of interest relating to Letsema.

It appears that it was Transnet that proposed Regiments as a substitute for Letsema.

1) How was Regiments selected? What was Transnet's involvement?

The extraordinary inflation of the scope, range and cost of services is demonstrated by the following narrative.

At the start of the process, in December 2012, the terms of the contract set out specific restrictions on the contract, notably that:
- financial advisory services were included in the remit ("Developing finance and funding options; Develop deal structure (financing, hedging and de-risklng options") and
- Payment for deliverables was clearly capped at R35.2m (excluding the legal advice) – with risk of overruns imposed on the bidder. The Letter Of Intent noted: "Dellverables must be executed for a fee of R35.2m as per the fee note below. Any overrun in terms of time will not be for the account of Transnet as the engagement is output based and not time based."

These restrictions were later completely ignored.

In May 2013 another potential conflict of interest was raised with McKinsey concerning Nedbank. An alternative solution was proposed that Regiments Capital would simply be substituted to provide the required services to Transnet in place of Nedbank.

2) What was the conflict and how did Regiments come to be selected on this ad-hoc basis?

3) More, generally, we have heard from several different sources that McKinsey was "persuaded" to use Regiments, despite the fact that in various cases Regiments did not have the required skills.

For instance, aside from the above instance, we are told that Regiments was appointed to provide operational consulting for the GFB project but did not have the required skills, to the extent that other consultants were brought in (Accompany Advisory) to patch up the process/product.
Please comment

4) In February 2014, Anoj Singh signed an addendum to the LOI with McKinsey which purported to revise the scope of work for the funding portion of the tender agreement.
This was signed by Eric Wood, who scratched out “McKinsey” and wrote in “Regiments Capital”.
Our understanding is the tender contract was with McKinsey, who took responsibility and risk as the “principal lead”.
On what basis did Transnet contract directly with a separate entity under the McKinsey contract?

5) The value of the contract also underwent the first of many increases - by R6m - despite the fact that the scope of work fell squarely within the original parameters.
Please comment.

6) It is alleged that Regiments – led by Wood – acted as Anoj Singh’s personal advisors, with neither their role, terms of reference, budget or deliverables clearly defined.
Please comment

7) In April 2014, Anoj Singh sent a memo to the GCEO, Brian Molefe disclosing that i.r.o the contract portion described as “Transaction advisory and procurement execution” McKinsey’s role was “de-scoped due to the extensive involvement of the Transnet executive team” - yet Regiments was paid R6,1 million under this banner.
Please explain what services Regiments provided in this regard that neither Transnet nor McKinsey could provide.

8) Regiments was paid the full R15 million as contracted for its revised fundingadvisory role, yet Singh in this memo proposes and receives approval for a post-facto revision in the fee allocation to Regiments, to add an additional fee of R78,4 million.
The calculation of the R78,4 million is a percentage based on estimates by Regiments itself on how much money its advice has supposedly saved Transnet.
Yet these figures are explicitly unreliable, with the memo noting: “The forecasts were based on using historical trends of appropriate indices as calculated by Regiments Capital. The calculations above are based on information available at a point in time to Regiments. The above calculations were prepared to demonstrate the impact of reducing the batch size and will not tie up to the final negotiated position.”
This amendment to the value of the contract took Regiment’s windfall from R20m to R99,5m.
This additional amount was not budgeted for and was allocated to the 2014/15 Capital budget, despite the Transnet Acquisition Council’s warning that this was impermissible.
Please comment.

9) The supposed cost savings were based on an accelerated delivery schedule, but we understand this has put serious pressure on Transnet’s cash flow, given the decline in rail tonnage. It should be noted that in its latest annual report Transnet cautions that a reduction in earnings associated cash flows from operations could result in it breaching its self-imposed gearing limit of 50% and its three-times cash interest cover.
It also discloses that, as of March 2016, zero deliveries had been made on the 232 Class 45 Diesel (from CNR) and the 240 Class 23 Electric (from Bombardier) locomotives.
Please comment.

10) Regiments was also appointed as transaction advisors and lead negotiator for the China Development Bank facility, without any competitive process. Outsourcing such a negotiation process was contrary to Transnet’s interests and normal practice, given that it had an experienced Treasury department. The CDB proposal was extremely expensive as was Regiments’ “arrangement fee” of more than R300 million.
Please comment

11) It is alleged that the current Transnet treasurer Phetolo Ramosebudi is close to Regiments’ Woods and proposed a number of transactions that benefited Regiments at the expense of Transnet. He also appears to be conflicted in that a close relative - REDACTED - worked for Regiments at the time and has followed Woods to Trillian. Please comment

12) On 28 April 2015, Ramosebudi compiled a proposal purporting to approve a “contract extension” for the appointment of Regiments Capital for transaction advisory services and support to Transnet on the 1064 locomotive transaction, raising its fee from the previous R99,5 million by R166m to total R265,5 million.

The document lists a series of supposedly innovative financial adjustments to the Chinese Development Bank loan structure.
It notes: “Regiments have been working together with the risk management/middle office of Transnet Treasury for over the last 12 months to achieve the outcome below.”

It claims that Regiments Regiments acted as lead manager with respect to the debt origination of the CDB loan and structuring/arranging cross currency and credit contingent default swap’s iro CDB loan.

It estimates the financial benefits that accrued to Transnet from the negotiating strategy “pioneered by Regiments” is calculated to be in excess of R2.7 billion.

It claims "the financial advice and negotiation support that Regiments provided through this entire process which took in excess of 12 months was done at risk with an expectation of compensation only on successful completion of the transaction".

a) Please explain how this saving was calculated and why there was no contract or deliverables in place for the claimed work that Regiments supposedly did “at risk”?

b) It is not clear to us what additional value Regiments provided. We are aware that Transnet had among the largest and most competent corporate treasuries in the country – and was fully equipped to handle this transaction without Regiments. This was also the view of Transnet’s external auditors who queried the payment. Please comment.

The document also purports to recognise Regiments Capital "having supported Transnet in the 1060 locomotive tender as the transaction adviser is the BEE and empowerment partner of JP Morgan to enable Regiments to benefit from a significant transfer of skill from JP Morgan…"

c) JP Morgan has denied having any such relationship with Regiments. Please comment

d) We are also informed that JP Morgan was asked to pay Regiments what appears to have been a form of commission payment iro of JP Morgan's work on the loan and cross currency swaps. We understand that Marc Hussey, head of JP Morgan in SA, refused. Please comment

13) Regiments was also engaged, without any tender process, to “assist” Transnet treasury to hedge the floating rate portion of loans by Standard Bank, Old Mutual Specialised Finance and Liberty Finance amounting to R4.4 billion by swapping the floating rates into fixed rates. The cost of this was undisclosed but included in the new interest rate. We are informed that this was very expensive, moving the rates from a WACC of between 8.3% and 8.7% to a WACC of 11.25% and 11.31% - a cost of about 300 basis points or R132 million per year.
Please comment.

14) In December 2015, Transnet repeated the same slight of hand with the R12 billion club loan, appointing Regiments, without any competitive process, to hedge the interest rate risk on the floating rate. Again, the difference was about 300 basis points, from 9.2% to 12.2% - or about R360 million per year.
Calculations done show that the fixed rate after the swap, should have been approximately 11.40% - 11.45% after a fair value fee is added. The swap was transacted by Nedbank at a fixed rate of approximately 11.85%.
This transaction could have easily been dealt by Transnet Treasury with no extra cost.
The difference between fair value and the transacted yield is more than R 100 million.
This suggests that both Regiments and Nedbank did not have Transnet's best interest at heart, but their aim was to maximise their income.
Please comment.

15) Regiments was used to execute a further floating/fixed swap on R11,3 billion worth of debt, using the Transnet Second Defined Benefit Fund as a counter party. It is not clear what the cost of

this swap is, but it represents a potential risk to the TSDBF, which would not normally assume such risks.
Please comment.

16) In May 2015, the Transnet Dealers were instructed by Ramosebudi to place an amount of R 2 billion on term deposit at Nedbank. The tenure was 6, 12 and 18 months. This instruction was untoward as Transnet is a net borrower in the Money and Capital markets. Most funding receipts are placed as call deposits, till the funds are utilized. Placing large amounts of funds for such long maturities is not good practice, and does notm ake sense, and has not been done before.
A complicated, risky and expensive put and call structure was put in place using the R186 government bond.
The structure was proposed by Regiments. This type of structure is not cost effective, does not manage carry cost, is speculative, untoward.
Please comment

17) We are told that many of Regiment's transactions (eg interest rate or currency hedges) on behalf of Transnet were done with Nedbank as their only counter-party because other banks were reluctant to trade with them as agent on Transnet's behalf.
These Banks find it strange that an agent transacts on Transnet Treasury's behalf, when Transnet has one of the most sophisticated Treasury departments in the country.
We are informed that, at one point, Nedbank decided that the reputation risk was too large and refused to continue paying Regiments as an “agent” of Transnet, insisting that Transnet pay Regiments directly.
Please comment.

18) The Transnet Procurement Procedures Manual (PPM) states the following with respect to the utilization of Consultants: "Transnet's Specialist Units/Functions must be utilized by other Transnet Entities for required
Goods and Services falling within their scope of expertise. The external market may not be approached for goods and Services falling within the strategic Specialist Units' or Division's core competency areas. The only exception to this rule is if the Specialist Units indicate in writing that they do not have the ability or capacity to provide the required Goods or Services."
Clearly, in relation to Treasury functions, Transnet’s own special unit had the ability to provide such services.
Please comment.

19) We are informed that Garry Pita was, at one time, friendly and socialised with Niven Pillay, of Regiments.
Please comment.

Thank you

Please do not hesitate to come back to me or my colleagues (copied above) if you have any queries.

Sam Sole

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