



Restructuring and Revitalizing ADDY: Evolution, not Revolution

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ADDY in perspective

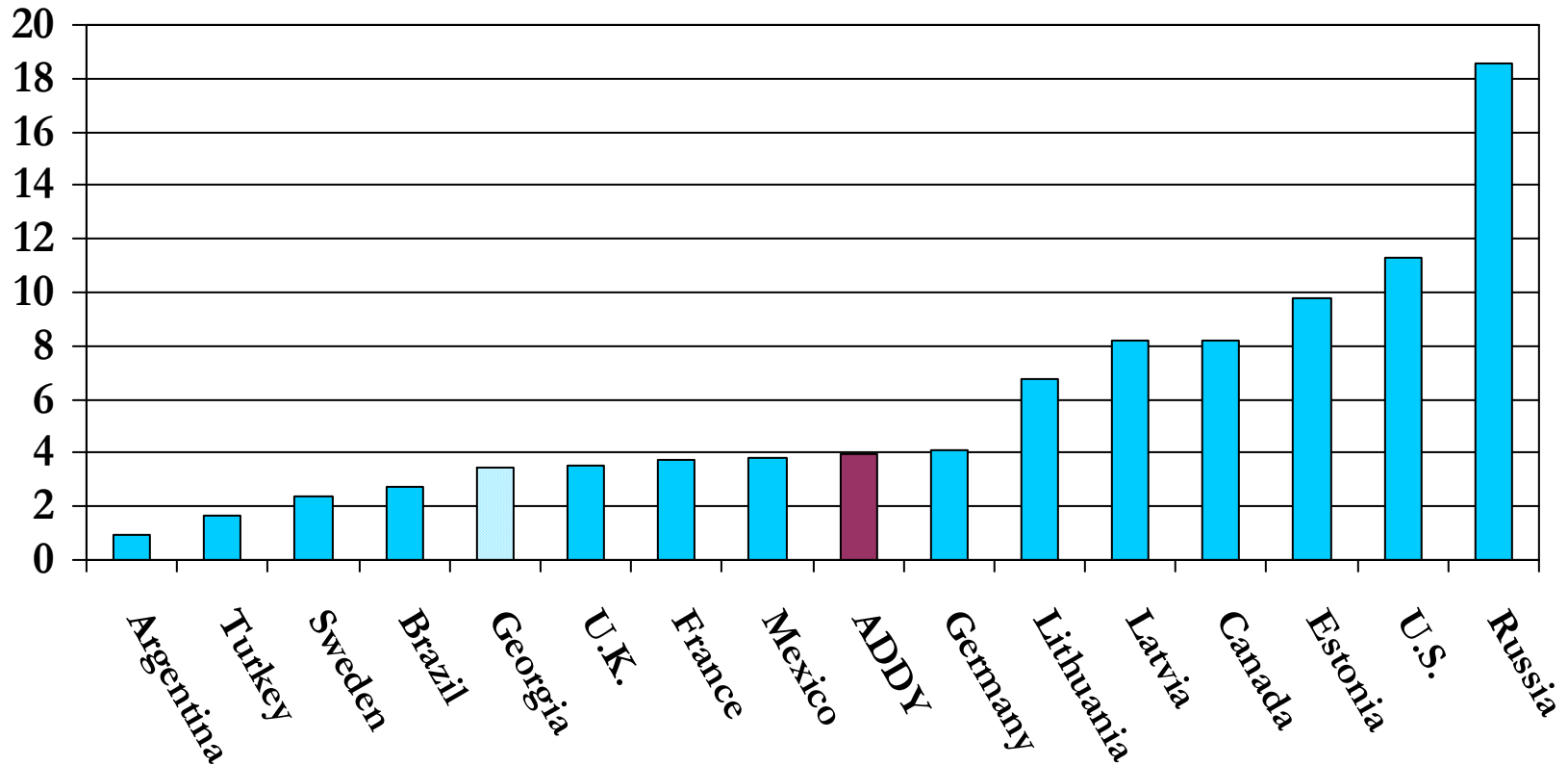


	Km of line	Ton-Km	Pass-Km	Employees
ADDY	2,122	7,719	654	29,461
Argentina	11,000	9,878		3,900
Brazil	21,659	59,700		12,700
Canada	53,300	436,900	1,370	41,500
Estonia	967	9,283	182	3,869
France	29,186	46,835	61,857	165,817
Georgia	1,575	4,855	614	17,544
Germany	35,755	76,950	70,785	170,413
Latvia	2,237	17,604	762	13,967
Lithuania	1,753	11,457	432	11,353
Mexico	16,000	61,051		17,200
Russia	85,835	1,433,617	157,901	1,222,200
Sweden	9,857	14,248	9,400	13,089
Turkey	8,697	8,612	5,878	24,060
U.K.	16,652	17,668	40,400	17,508
U.S.	194,746	2,183,277	8,965	175,000



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Traffic density (TU/Km)



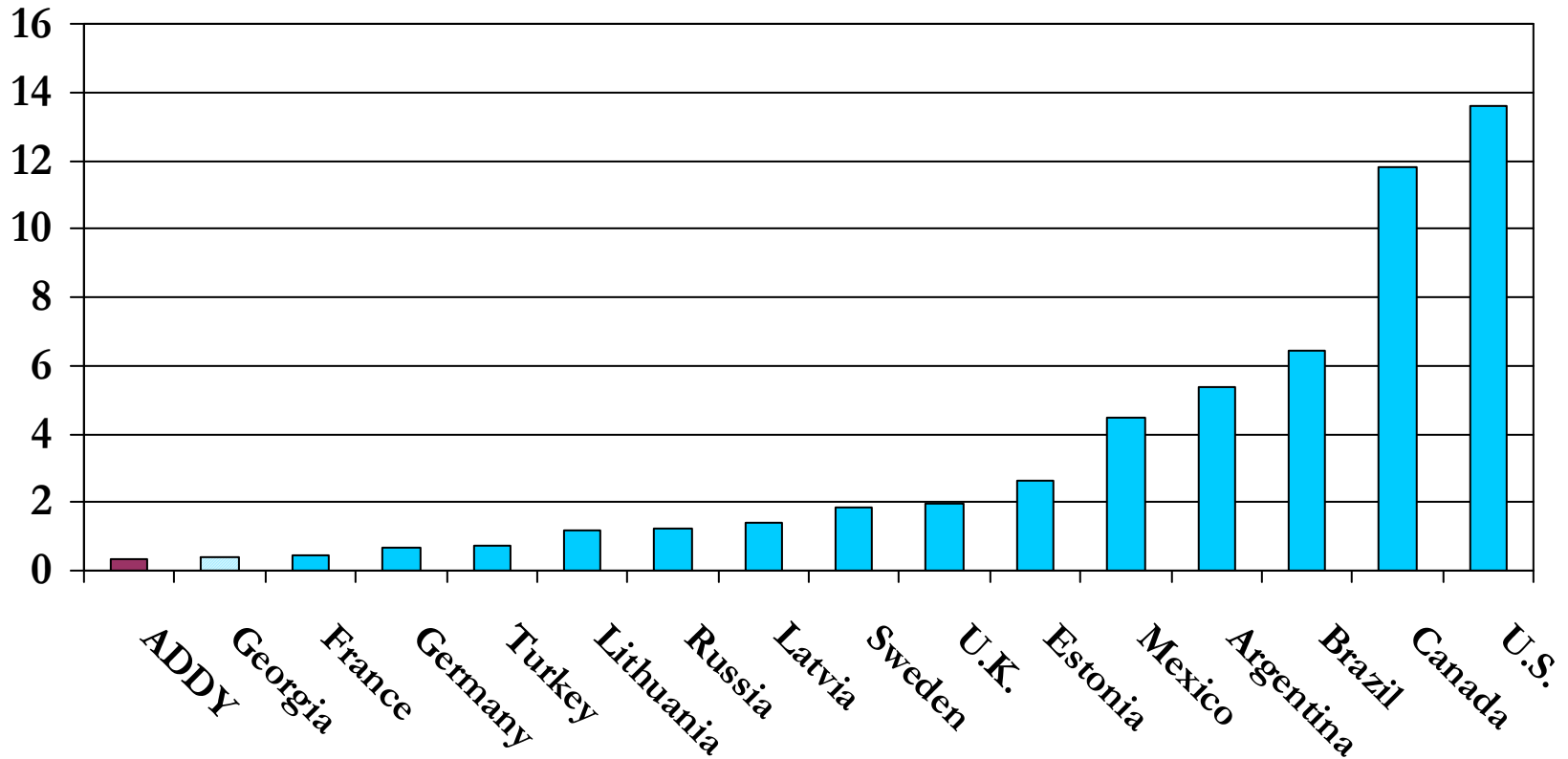
TU=Ton-Km + Pass-Km



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Employee productivity

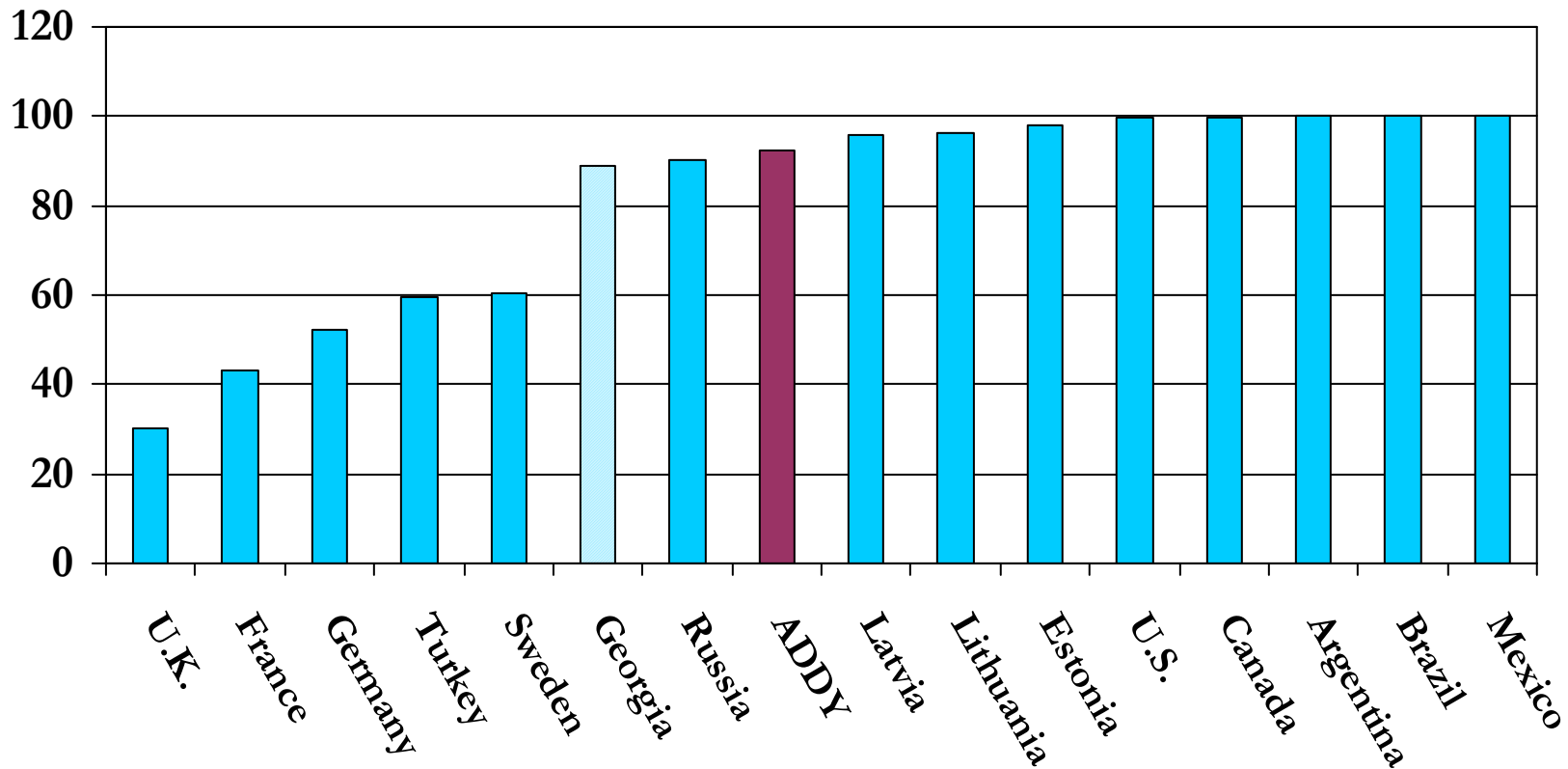
$((\text{ton-Km} + \text{passenger-Km}) / \text{Employee})$





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Percent of TU as freight



TU=Ton-Km + Pass-Km

Basic business model alternatives: structure and ownership interactions



Structure	Ownership		
	Public	Mixed	Private
Integral (Monolithic): infrastructure and all operations under unified control	China, India, Azerbaijan	Indian Railway Container Corp, Latin American freight and passenger concessions	Smaller US freight railroads, East Japan, Central Japan and West Japan
Dominant carrier integral with infrastructure, tenant carriers or operators separated but paying access charges	Amtrak and VIA, Japan Rail Freight, Russia, Island JRs	US freight and commuter railways in the Northeast Corridor, CN and CP	US Class I Freight railways with trackage rights, JB Hunt (an "operator"). Russian "operators"
Separation (accounting or institutional) of infrastructure from all carriers or operators	"Standard" E.U. model	Some U.K. franchises, Network Rail in the U.K.	Most U.K. franchises, Railtrack (but not Network Rail), U.K. freight carriers

Related issues



- Accounting versus institutional separation
- Independent agencies versus holding company management
- Carriers versus “operators”
- Public/private spectrum: public, management contract, franchising, privatization

Potential Public/Private roles



Type of Function	Traditional Public Roles		Franchising/Concessions		Privatization	
	Public Ownership and Mgt	Mgt Contracting	Gross Cost	Commercial Risk	Divestiture	New Private Entry
Infrastructure	X	X	X		(Railtrack?)	
Freight	X			?	X	X
Passenger						
High Speed	X			X		
Intercity	X		X	X		
Rural/regional	X	X	X			
Suburban	X	X	X			



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Examples of rail structures



Country	Public	Mixed	Private	Type of infrastructure separation
Azerbaijan	All infrastructure and carriers		Transcaucasus?	Integral
Argentina	Intercity passenger carriers. Infrastructure is publicly owned by concessioned to private carriers		Suburban passenger carriers (and Metro) and all freight concessions.	Dominant Carrier
Brazil	Metro and suburban passenger services in Sao Paulo. Infrastructure is publicly owned but concessioned		Metro and suburban passenger carrier in Rio de Janeiro and all freight carriers are concessioned	Integral
Estonia	Tallin public transport	Infrastructure and freight company (70/30 shares)	Russian operators (Spacecom)	Institutional separation
France	Infrastructure (RFF) and all intercity operators (SNCF)		A few small passenger operators and one freight company (Connex)	Institutional, but SNCF retains control
Germany	DB holding Company (Netz, Regio, Railion. Intercity)		157 freight carriers and 150 passenger operators (some franchised)	Accounting under holding company
Mexico	All infrastructure is concessioned	Mexico City suburban	All freight carriers are concessioned	Dominant Carrier
North America	Amtrak and VIA (national passenger carriers). Suburban passengers	Contract commuter services	All freight companies, and some suburban passenger contracts	Dominant Carrier
Russia	RZD holding company (infrastructure and all carriers)	Some local suburban passenger carriers are JVs	30 or so private operators own 1/3 of all freight wagons	RZD holding company
Sweden	Infrastructure is State Agency (Banverket). Freight company (Green Cargo) will be privatized. Main intercity passenger carrier (SJ)		Many passenger franchises	Institutional
U.K.	Some passenger franchises taken over by SRA	Network Rail	Freight company (EWS) and 20+ passenger franchises	Institutional

Current problems

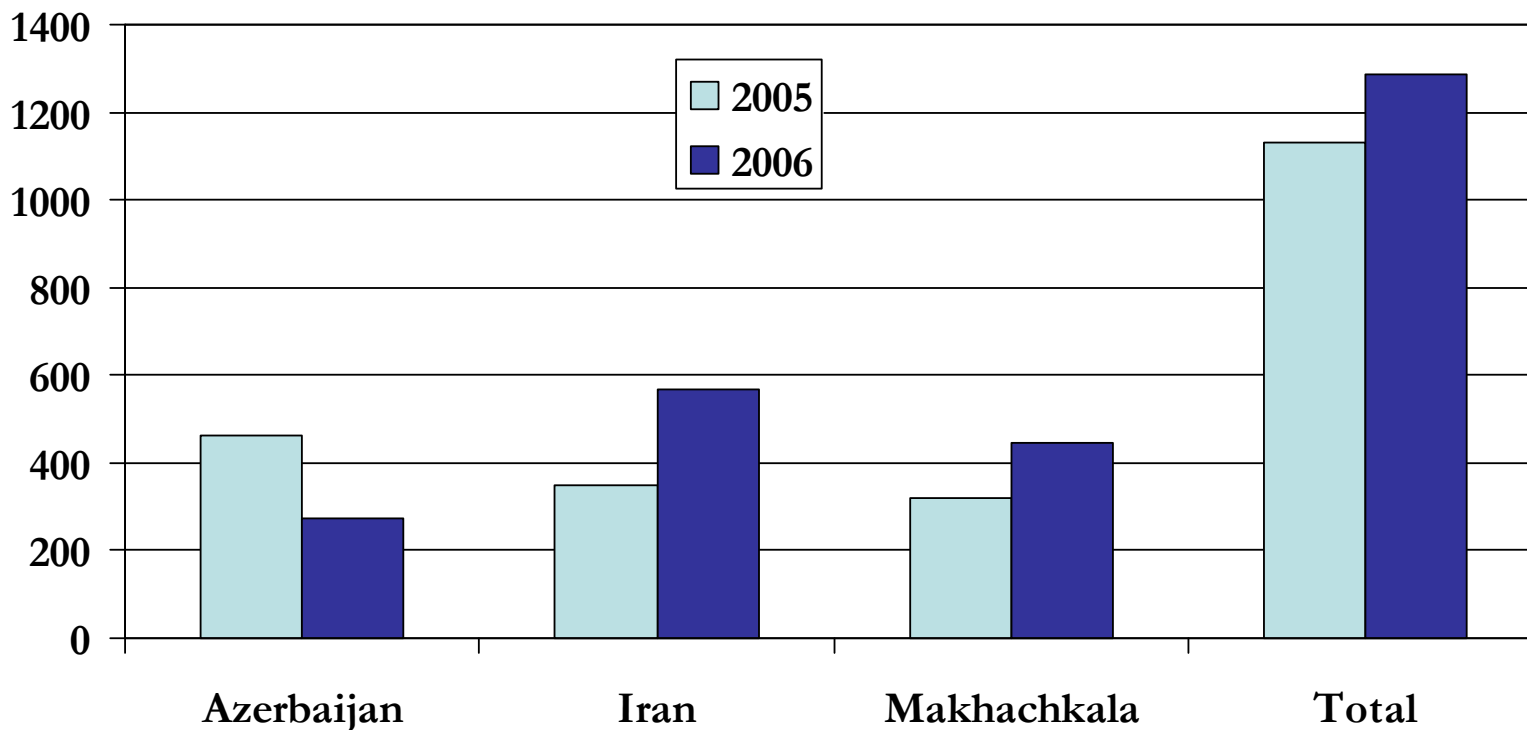


- Aged and poorly maintained locomotives and infrastructure
- ADDY losing traffic to Russia and Iran
- Operational inefficiencies and practices raise costs and reduce service quality and capacity
- Corporate Governance:
 - No focus or information on business issues
 - Unclear definition of passenger services and inadequate passenger financing
 - Paying taxes with inadequate maintenance?

Kazakhstan and Turkmenistan rail exports of oil and oil products through Azerbaijan, Iran and Russia (month of August)



000 tonnes



Basic assumptions



- ADDY must comply with new legal requirements for structure
- Plan should promote financial transparency to ensure adequate earnings and target Government resources
- Infrastructure/rolling stock need external help for investment and maintenance in short term only
- Freight and passenger competition on same line are not objectives
- Private ownership or management are generally not objectives except for freight wagons and possibly locomotives



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Restructuring objectives



- In longer term, ADDY freight and infrastructure must be financially self-sustaining
- ADDY earnings must be adequate for freight and infrastructure financing needs
- Over appropriate time, operating practices should be made more modern and efficient
- Passenger budget should be clearly separated and, if possible, self supporting (access charges important)
- Passenger service definition and provision fully responsive to Government requirements
- IAS/IFRS accounting and reporting for cost and profit centers must be implemented
- ADDY corporate governance must be consistent with modern management practices: enterprise fully separated from Government
- **Feedback needed: this is a proposed, initial list**

Narrowing the options



Objective or Assumption	Structure			Remarks
	Integral	Dominant Carrier	Separation	
Comply with new legal requirements	Fails	OK	OK	Some change needed
Promote financial transparency				
Infrastructure	Fails	OK for passenger	Best, but costly	Separation could be accounting or institutional
Freight operations	Fails	OK for passenger	Best, but costly	Same
Passenger operations	Fails	Best	Best, but costly	Same
IAS/IFRS accounting and reporting	Marginal to neutral	OK	OK	IAS/IFRS possible for all options
Support external financing	Marginal	OK	OK	Clarity promotes external financing
Sufficient earnings for freight and infrastructure	Fails	OK	OK	Clarifies passenger financing
Competition on same line	Fails	Fails	OK	Competition not needed?
Private role				
Infrastructure	Fails	Fails	OK	Not an objective?
Passenger operations	Fails	OK	OK	Not a near-term objective
Freight wagons	Marginal	OK	Best	



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The proposed change in perspective: from yellow box to green boxes



Structure	Ownership		
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Separation (accounting or institutional) of infrastructure from all carriers or operators	"Standard" E.U. model	Some U.K. franchises, Network Rail in the U.K.	Most U.K. franchises, Railtrack (but not Network Rail), U.K. freight carriers

Proposed new structure



Current ADDY Function	New Structure	Remarks or options
Planning, tariff oversight, safety oversight, transport policy	To MOT	Separate the enterprise and government roles
Infrastructure	Remain with new ADDY holding company	Accounting cost center. New holding company to be government owned open jsc
General Freight Carrier	Remain with new ADDY holding company	Accounting profit center, maintains freight and passenger locomotives, and freight wagons
Oil Traffic	ADDY contracts to haul trainload lots	Accounting profit centers. Transcaucasus, other agents/shippers may become "operators," not carriers. Operators can own/maintain wagons and locomotives
Intercity passenger	Initially a division of ADDY, but may become separate entity	Accounting profit center. Maintains intercity passenger coaches. Pays marginal cost access charge. Supported by national government
EMU carrier	Separate carrier controlled and financed in Baku area	Accounting profit center. Maintains EMU coaches only. Pays marginal cost access fee. Supported by local and national government. Could be franchised eventually

Who owns and manages what?

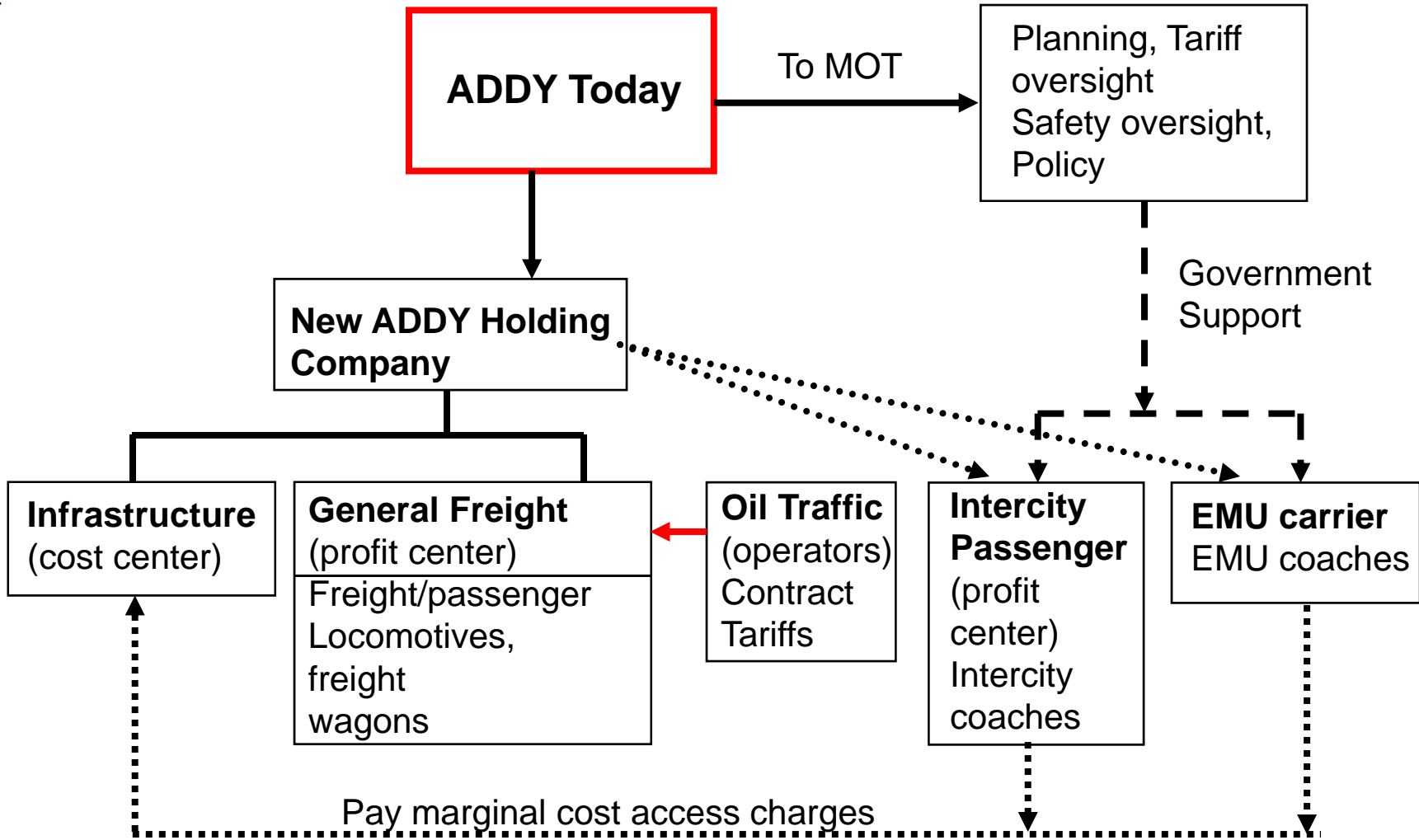


- As part of the holding company, **infrastructure** owns and controls track, electrification, freight stations, freight offices (may own passenger stations as well)
- Under holding company, **general freight carrier** owns locomotives, wagons, rolling stock maintenance facilities. Will also probably maintain passenger locomotives under contract
- General freight carrier serves as contact carrier for oil “**operators.**” Oil operators may own and provide their own wagons and locomotives
- **Intercity passenger**, initially a division under the holding company, may be spun off to separate (government owned) corporation. Owns and maintains main passenger stations and passenger coaches, contracts for maintenance of locomotives, operates trains and pays marginal cost infrastructure access fees.
- **EMU passenger**, initially a division under holding company, spun off to local control. Owns and maintains main stations and EMUs, operates trains, pays marginal cost infrastructure access fees



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Proposed new structure



Carriers and operators



- A “carrier” owns locomotives, provides crews, issues public tariffs and moves all traffic on offer
- An “operator”:
 - Could be a shipper, a forwarder, or an agent (for example, Transcaucasus or Middle East Oil could become operators)
 - May provide wagons and/or (either owns or leases) with suitable tariff agreement
 - Contracts with **ADDY carrier** to move multiple wagonload or trainload lots
 - Tariff is volume based, may be public and regulated

Issues in implementation



- Restructuring committee (ADDY, MoT, MoF, Shippers?)
- Adjust regulatory authority to new structure (structural, competitive, regulatory triangle) and establish regulator
- Separate enterprise from government roles and create ADDY Holding company
- Set up passenger agreements or agencies and funding authority

Improving finances for freight and infrastructure

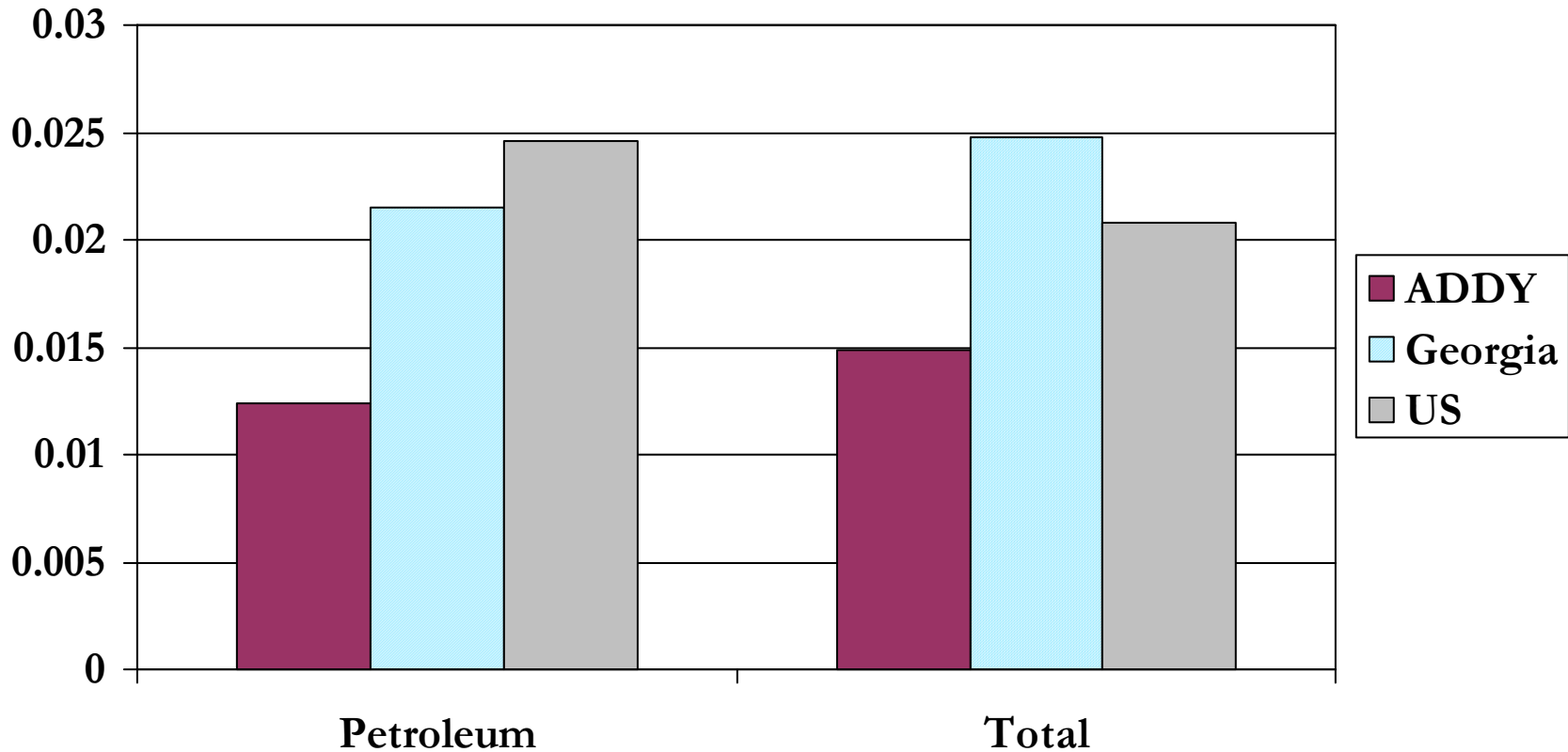


- Improved operational efficiency
- Direct government oversight and support for passengers
- Improved freight revenues (oil)
- Direct government support to infrastructure (EU model)?



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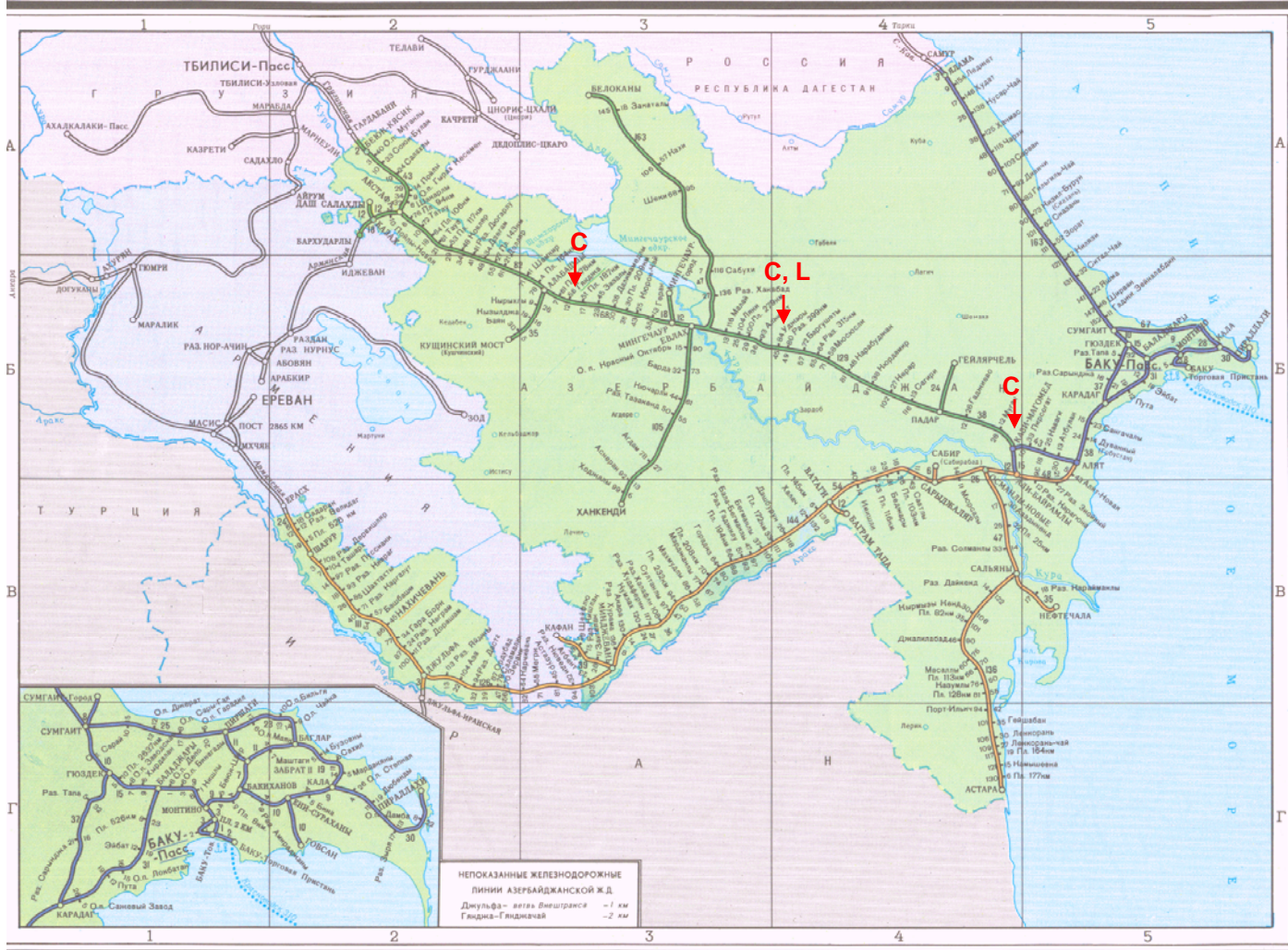
Revenue/Ton-Km (US \$/Ton-Km)





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ADDY

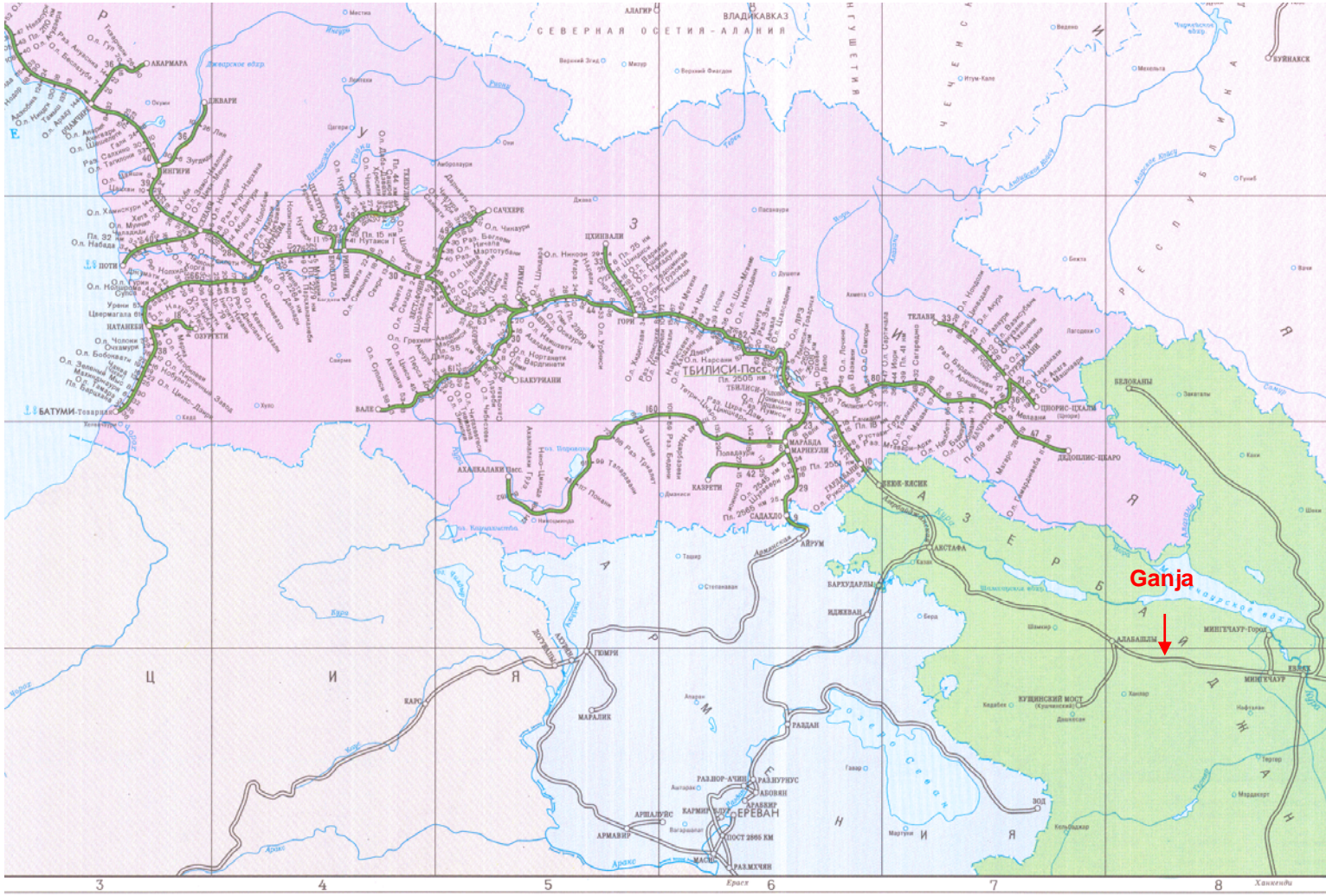


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ADDY Cash Flow Analysis



(thousands of new Manat) Old Manat=5,000 to 1 New Manat	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2002 to 2005</u>
					5,000 per new Manat
Income before tax	56,177.9	41,737.4	40,397.0	25,617.1	163,929.4
Depreciation	18,960.1	19,027.8	18,688.4	19,362.9	76,039.1
Accounts Receivable	2,254.0	1,292.2	(13,832.3)	(16,732.3)	(27,018.4)
Accounts Payable	(24,676.6)	(17,150.8)	13,341.1	22,102.0	(6,384.3)
Income Taxes Paid	(12,399.2)	(7,841.9)	(11,047.0)	(8,066.9)	(39,355.0)
Other Current Assets and Liabilities	(6,039.1)	(15,349.7)	(3,101.0)	(12,184.3)	(36,674.1)
Operating cash flow	34,277.1	21,715.0	44,446.1	30,098.5	130,536.7
Capital expenditures	(24,093.5)	(34,166.3)	(39,425.6)	(36,105.1)	(133,790.5)
Free cash flow	<u>10,183.6</u>	<u>(12,451.3)</u>	<u>5,020.5</u>	<u>(6,006.6)</u>	<u>(3,253.8)</u>
Asset disposals	(1,842.5)		(12,580.1)		(14,422.6)
Net proceeds/(expenditures) on long term investments				86.4	86.4
Net proceeds/(expenditures) on short term investments					
Net proceeds/(expenditures) on long term borrowings	(2,038.9)	1,854.5	(782.6)	10,263.0	9,296.0
Net proceeds/(expenditures) on short term borrowings	(6,784.2)	10,910.4	8,435.4	(3,889.8)	8,671.8
Front-end Commission (repayment)					
Increase/(decrease) in additional capital					
Other long term assets and liabilities			77.2		77.2
Net cash flow	<u>(482.0)</u>	<u>313.6</u>	<u>170.4</u>	<u>453.1</u>	<u>455.0</u>
Depreciation	18,960.1	19,027.8	18,688.4	19,362.9	76,039.1
Capex less depreciation	<u>5,133.4</u>	<u>15,138.5</u>	<u>20,737.2</u>	<u>16,742.3</u>	<u>57,751.4</u>