

FINANCING THE NACALA CORRIDOR —

First Private Sector Integration of Port and Rail



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My agenda will be as follows: a brief background on Railroad Development Corporation (RDC); then we'll talk about the Nacala Corridor with a lot of detail and compare that with Guatemala, which is another example of a rail concession; and finally draw some conclusions.

Background on RDC

RDC is a small company, privately held and based in Pittsburgh. We describe our business as *Emerging Corridors in Emerging Markets*, meaning that RDC does not just get involved with railways, but railways in conjunction with ports such as on the Nacala Corridor or, in the case of Guatemala, trying to develop the right-of-way for alternative uses like electricity distribution and other types of businesses. I would also like to highlight that everything RDC does is the result of Joint Ventures. In each of our businesses we have partners; we bring skills to the mix that complement our partners' skills. So today I am not just discussing RDC, but the results of RDC with our partners.

Table A shows a broad overview, listing the countries and railways in which we are involved. There is a broad mix from the Iowa Interstate Railroad in the USA hauling 8.5 million tons in contrast to Guatemala which hauls 0.16 million tons. Interestingly enough, our biggest business is in Estonia in Europe where the railway annually hauls 42 million tons. I would like to add that RDC is the smallest shareholder in Estonian Railways. Generally speaking, the better the deal, everybody wants in, so our participation is relatively small.

Table A

Country	Entity	Length (km)	Employees	Tons Y. 2004 (in millions)
USA	Iowa Interstate	1,005	181	8.5
Argentina	ALL Central	5,350	1,012	3.4
Argentina	ALL Mesopotamica	2,740	313	1.4
Guatemala	Ferrovias Guatemala	322	115	0.16
Peru	Ferrocarril Central Andino	591	111	1.7
Malawi	Central East Africa Railways	797	487	0.3
Estonia	Eesti Raudtee	693	2,536	42.1
Mozambique	Nacala Corridor	872	227 Rail	0.3

The accomplishment that I am most proud of is that our railroad in the USA, the Iowa Interstate, won the Gold Harriman Award for Safety. I know that sometimes there is the tendency to think that capitalism equals cutting corners, but I can assure you that at RDC this is a matter of personal pride; we have built a

safety culture. In the year 2003 we had No Injuries at all for the entire year on the Iowa Interstate, resulting in the Gold Award. This is the type of culture that we hope to spread to some of our other railways and we are in fact being successful in this.

RDC Investment Parameters

Concerning investments, RDC has learned over the years that there are several critical factors, especially involving railway concessions, that make or break whether one should be investing in a particular country. In descending priority they are:

1. **A committed seller.** This means a government that is serious about concessioning and not just going through the motions because someone has been awarded a consulting contract to float the idea of concessioning; there are plenty of those out there! We pride ourselves on our ability to avoid wasting our time in countries that are not serious.
2. **Rational competition among bidders.** As discussed yesterday, if we see the national railways of India or South Africa bidding against us, I confess to you that I do not have as much money as the Treasury of South Africa nor the Treasury of India. So we are not likely to be serious competitors; we tend to choose our battles; and we look at the competition before we take a serious look.
3. **It is very important to have local partners.** We know a lot about railways but we don't know anything about Africa, Guatemala or Peru. Many of the things that we have been able to achieve have not been a result of what we've done, but rather the result of whom we've chosen to be affiliated with. Our local partners carry a lot of the load in most situations.
4. **Yes, railway skills are important.** At this point we have amassed quite a body of experience in some of the most difficult railways in the world, and we do bring value to the table in this regard.

CASE STUDY: Financing the Nacala Corridor

Let's discuss the Nacala Corridor as a case study. In quite simple terms the Nacala Corridor consists of the Nacala Port in Mozambique, the Nacala Railway in Mozambique, and the railway in Malawi. For us this process began in 1996, beginning with the negotiation of a concession on the Mozambique side. Malawi subsequently decided that they needed to be proactive, and as a result they went ahead and concessioned Malawi Railways. This corridor was thus not concessioned as a package; each country did their own thing. We took it on faith that eventually we would be able to put the pieces together, but of course didn't expect that it would take 5 years!

The Malawi concession occurred in 1999, but unfortunately we ended up with half of a railway for quite some time. We did not have operational or financial involvement on the Mozambique side, so we were effectively competing in Malawi with one hand tied behind our back. Compounding this was the cyclone in 2003 which took out, among other things, a bridge and because we did not have financing, there were no resources to fix the bridge. Finally, we did close on the Mozambique side in 2005, but by that time

they were down to 4 locomotives! Can you imagine running half of a railway with 4 locomotives? This was the legacy of the delays of incomplete financing and many other factors. But the fact is that we took over this operation with only 4 locomotives.

The financial package consisted of 25% private equity (from RDC and our partners); 75% debt came from OPIC (U.S. Overseas Private Investment Corp.) after a 5-year search for financing and we are very much grateful to them. Also in the interim there was donor support due to the famine in addition to the cyclone; donors got involved with the Rivi Rivi Bridge project. But the most important thing is that in neither Malawi nor Mozambique did we go back to their governments to renegotiate the deal because we did not project or structure properly. Our standard is to honor our commitments. It took a long time, longer than it should have; but we did come through and honor our original commitment to both governments.

Back to the donor role; pictured is the nearly completed bridge at Rivi Rivi in February 2005 whose predecessor was taken out by Cyclone Delphina in 2003. In this particular case there was a mix of financing that went into this project, ranging from the railway company to USAID, the UK fund DFID and even the Malawi Army. Recall that this morning we heard the example of Gabon; when it's everybody's problem, everyone has to work on it. This project is one of the things that happened while we were waiting for the financing to close.



Structural Trends in African Privatizations

On a bigger picture, let's look around Africa and see what the structural trends are in terms of how some of these concessions come together. **Table B** is probably an unfair exhibit because it was put together before India was selected for Tanzania among other things. However, there is a recurring theme. In most of the concessions in Africa, Spoornet or Spoornet through shareholding is participating in most of these deals. When I referred earlier to not wanting to compete with the government of South Africa or the government of India, this is one of the reasons why you'll find RDC on the Nacala Corridor, but not bidding for some of these other projects.

Table B

	Rail Investor	Ultimate Owner
SITARAIL (Cote D'Ivoire/Burkina)	COMAZAR	Govt. of South Africa
CAMEROON	COMAZAR	Govt. of South Africa
SIZARAIL (DRC)	COMAZAR	Govt. of South Africa
ZAMBIA	SPOORNET	Govt. of South Africa
NACALA CORRIDOR	RDC	RDC & Partners

At a structural level I think there has been a shift in Africa. Historically, financing came from the donors. The donors would hand out free locomotives or track rehabilitation programs or other things. Now that has shifted. Now there is an emerging cadre of private sector operators like Eitan Dvir and Eric Pfeifer. A number of private companies have emerged in various structures to compete for these options, and yet, we

also have the emergence of Indian Railways as a competitor, etc. etc. And there are still aid programs out there. So it is a very murky environment in terms of trying to decide who the competition is going to be.

But let me give you a stark example of why aid programs don't work. Below are photos of donor locomotives taken "before" and "after". **Photo 1** is a sample of the locomotive fleet when they were first donated, and **Photos 2 and 3** are what they looked like a couple of years ago—every picture tells a story. It is not hard to see the result of what happens when you give someone something; if they don't pay for it, they don't respect it.



Photo 1 (1994)



Photo 2 (2003)



Photo 3 (2003)

CASE STUDY: Financing Ferrovias Guatemala

Africa is not the only place in the world where it is difficult to invest in and operate railways. A more difficult example, even by African standards, I believe is Ferrovias Guatemala. The national railway system was closed by the government in 1996 and then they went looking for the private sector to wave the magic wand and pay the premium for the privilege of putting this national railway back into operation. Well, they only got one bid and that was from RDC.

We were only willing to commit putting the northern part of the railway back into operation because the southern part was too far gone and we didn't want to take the risk of doing the whole thing. We made the commitment; got the concession for 50 years from the government; and began the rehabilitation work. Then in 1998 Hurricane Mitch struck. Recall that Cyclone Delphina happened to us in Africa; Hurricane Mitch happened to us in Guatemala. One of our friends said that disaster follows us "like tornadoes to a trailer park;" we seem to have the knack for getting into these projects just before natural disasters occur.

But in 1999 we actually got the railway running from Guatemala City to the Atlantic. However, it is also a fact that in 2005 we still have not been able to finance reopening the rest of the system. So if you think Africa is difficult, this is not the only difficult environment.

In the case of Ferrovias Guatemala there was no debt because the project was so risky and the assets were owned by the State. It wasn't really possible to raise debt, so it was 100% private equity and basically quasi-equity like commercial paper, etc. Additionally, in Central America there are no Donors.

To make matters worse, after getting involved with the project, we were declared by the various financial institutions that fund infrastructure projects around the world to be an environmental problem. The reason that putting a railroad back into operation is considered an environmental problem is because while the railway was abandoned, people built houses, shops, etc. on the track. When we started running trains again, they had to move. So we were displacing an indigenous life form, which meant we were declared a “Category A Environmental Problem”. This means that the only way to get financing is to pay a consultant \$100,000 to go out and interview these people and ask for their permission to finance the project. Talk about walking around with a gun pointed at your own head! This is why we had to do this on our own.



But the most important point is that we made a commitment and it turned out to be approximately ten times what we thought it was going to cost. It is extremely expensive, but we honored the commitment.

Structural Trends in Central America

Comparing Central America with other parts of the world is very much like Africa — a lot of small, disconnected railways that don’t connect with each other and were never designed to connect with each other.

But unlike Africa rail is almost so far down the list of priorities that people don’t even think about it in regional initiatives, like Plan Puebla-Panama which is integration of Central America with North America. And the social problems in many respects are worse than some of the things that you’ll find in this part of the world.

Is this a success story? In this particular case I think it is very much a work in progress. I can tell you from the perspective of Guatemala that having a barely functioning railroad is better than having an abandoned railroad; and we are continuing to make progress commercially.

Conclusions

So let’s look at the Nacala Corridor in context and draw some conclusions. Table C shows how the Nacala Corridor compares with some of our other businesses.

Table C

	GUATEMALA	NACALA CORRIDOR	ESTONIA
TONS 2004	157,000	300,000 Rail	42,000,000
LINES OF BUSINESS	Atlantic: containers, steel, sugar Pacific: ? Electricity rights-of-way, etc.: ?	Port & Rail	Oil, fertilizer, metals
PURCHASE PRICE	\$0 + 10% of Revenue	\$7 million + \$2 million/year + 5% of Revenue	\$60 million for 66%
INITIAL FINANCING	RDC Local Capital Markets	SDCN OPIC CFM	Strategic investors Int’l Capital Markets IFC

Estonia hauled 42 million tons but on the Nacala Corridor about 300,000 tons moved by rail. And yet the investment in the Nacala Corridor is something like \$10 million and in Estonia for a railway that moves several quantum levels of traffic more is like 6 times as much. So there is a disproportionate amount of financing required to make the Nacala Corridor work. This is the bad news.

The good news is that relative to an operation like Guatemala, the Nacala Corridor is a relatively good deal. However, in our own defense Guatemala has a lot businesses attached to it that we just don’t know what they’re worth; for example, the ability to run electricity rights-of-way, develop the undeveloped ports, etc. And the purchase price was \$0. Our commitment was to put the railroad back into operation and give 10% of the *revenue*, not the profit, revenue to the government. Each is different but it is interesting to see how these deals contrast.

I would like to make a comment about financing. In our experience the multi-laterals have found it very easy to do business in Europe. For example, part of our financing in Estonia came from IFC (see Table C). Getting financing for developing countries is more difficult. In fact, political correctness—things like squatter policies that prevented us from getting financing in Guatemala—has caused needless deaths.



Photo 4 (Guatemala 2000)



Photo 5 (Guatemala 2001)

Photo 5 shows a container that fell off and hit a bus, killing 23 people. If Ferrovias Guatemala had 25% of the container market, which is normal market share in North America, then saving 25% of those 23 people means that there would have been people alive if we would have been able to get financing. In the meantime, we struggle more slowly.

Nacala Corridor Inspection Trip

Now I would like to share with you a trip I took on the Nacala Corridor. As a railway investor, the best way to see a railway is from the cab of a locomotive. So in late February, early March 2005, I made the trip from Nacala to the Rivi Rivi Bridge which is north of Nkaya.



Photo 6



Photo 7



Photo 8

Photo 6...In the port of Nacala there is a lot of container traffic. At one point there were 500 containers backed up as a result, among other things, of the delay in the privatization and the stagnation effect of having a plan that kept getting delayed. **Photo 7**...Note the track conditions at the Nacala Port. There is a stone holding the switch point open. This is environment that we stepped into in January 2005. **Photo 8**...We have to start somewhere, so we are rehabilitating the tracks at the Nacala Station and we are gearing up to do a main line track program.



Photo 9



Photo 10



Photo 11

Photo 9...But let's take a ride on the Nacala Corridor. Here is how a big shot like myself travels by train. This is a converted guard's van that we outfitted as a caboose with bunks, stove, etc. The man in the picture is Johan Beneke, who was referred to us by Braam le Roux. Mr. Beneke has brought some very important innovations to this operation. We're looking to keep trains moving by having double crews, and one of the ways to accomplish this is by having a caboose operation. **Photo 10**...Inocencio Horacio is seeing me off for my ride from Nacala to Malawi. **Photo 11**...Here is a picture that embodies the whole trip—note that all of the windows are broken in the locomotive. What you don't see is that the door was also about to fall off. These locomotives are basically junk that have been kept running for a long time with very makeshift maintenance.



Photo 12



Photo 13



Photo 14

Photo 12...And yet, the crew turned out in spotless attire and the driver is wearing a necktie. There is a latent pride and a railway culture which we hope to not only preserve but also grow amongst the cadre of people on the Mozambique side. **Photo 13**...We also provide an important service to the communities along the line by running a passenger operation between Cuamba and Nampula. This is a big passenger train with 8 coaches

including a dining car and an air-conditioned first class car and 6 parcels wagons. **Photo 14**...Here the people have turned out to unload parcels traffic. As I said, this is a social service; is part of the concession; is a subsidized service; and we are proud to operate something that is so important for the communities along the line.



Photo 15



Photo 16



Photo 17

Photo 15...But look at what we're working with—this is the workshop in Nampula. **Photo 16**...This is what is left of the locomotive fleet. A lot of these locomotives were destroyed in collisions; a lot were cannibalized; and the bulk is being cut up for scrap even as we speak. **Photo 17**...this is a picture of 2 locomotives, i.e. 50% of our working fleet. Recall that I said that we were down to 4 locomotives on the day we took over. Here is the locomotive depot in Nampula and there are 2 locomotives there for repair.



Photo 18

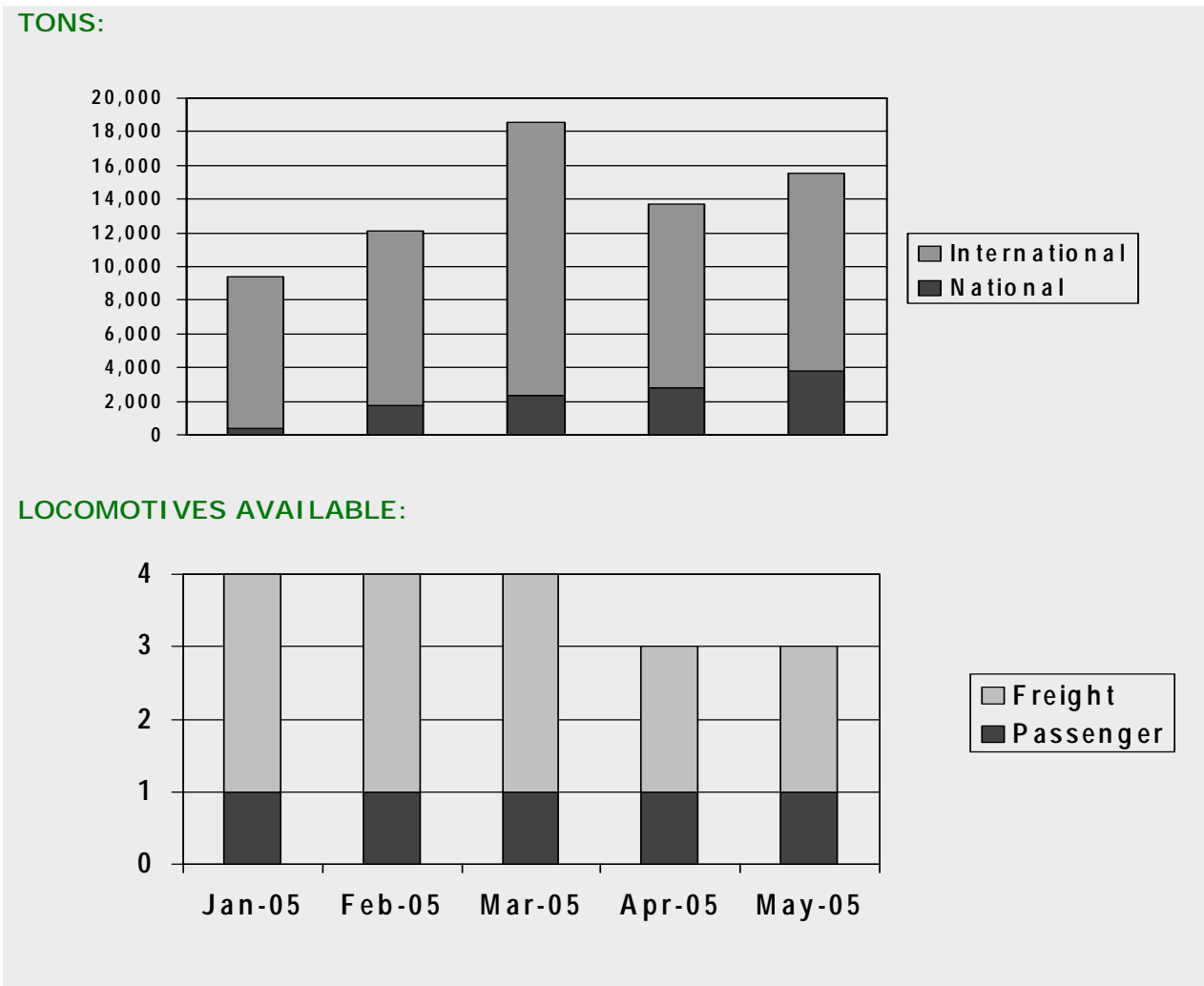


Photo 19

Photos 18 and 19...Moving on to Malawi, here is the Rivi Rivi Bridge project. This is basically a prefabricated bridge that arrived in containers and is being

assembled on site. This is a very interesting construction technique that reminds me of the Erector Set I had when I was kid. This is a very effective solution.

Graph A
Nacala Corridor – Mozambique only



Graph A is most interesting. It is easy to talk in generalities, but one of the things that you can't fudge is the operational results of the railway. This graph shows two things. The top portion shows the tons moved month by month while the bottom portion shows locomotive availability. Notice that we start with 4 locomotives of which 1 is for the passenger train which means we really have 3. Then we go down from 4 locomotives to 3, meaning 2 for freight service and 1 for passenger. When I say 2 for freight service, that includes shunting. Despite this, look at what we have achieved traffic-wise in the top portion. Our management team has been very effective in terms of utilization. Once we get our locomotive problems solved with a combination of solutions from leased locomotives to rebuilt locomotives, then this business will go according to the original business plan.

Let me close by borrowing a Mozambique phrase, “A luta continua!” (English translation: “The struggle continues!”) This is a struggle and I have tried to not pull any punches in terms of how difficult it has been. The important thing is that there are a lot of committed parties bringing various skills to the table. We’re going to make this work for the simple reason that we’ve committed to making this work. It would be helpful if there were more financing available, but even if there isn’t more financing, we’ve gotten this far based on our own resources and resources that we’ve been able to grab and whittle from other organizations. Everyone is committed; our reputations are on the line; and we want this to be a model for Africa because the Nacala Corridor is as good as any an example of why concessioning works.



Thank you.

[END]