SUMMARY OF OPERATION EVALUATION

A state owned railway

Central Asia

October 2014

EBRD EVALUATION DEPARTMENT

European Bank
for Reconstruction and Development
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This report was prepared by Hiromi Sakurai, Principal Evaluation Manager, of the EBRD Evaluation department.

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Abbreviations

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<th>Abbreviation</th>
<th>Definition</th>
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<tbody>
<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<tr>
<td>EvD</td>
<td>Evaluation Department</td>
</tr>
<tr>
<td>MDB</td>
<td>multilateral development banks</td>
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<tr>
<td>OPA</td>
<td>operation performance assessment</td>
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<tr>
<td>TIMS</td>
<td>Transition Impact Monitoring System</td>
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</tbody>
</table>

Defined terms

- **The Restructuring Loan**
  - a loan with possibility to convert into equity
- **The Operation**
  - The investment operation financed from the Loan and the TC Operation
- **The Operation Team**
  - The staff in the Banking Department and other respective departments within EBRD responsible for the operation appraisal, negotiation and monitoring, including the OPA preparation and finalisation.
- **The Project**
  - The project to support the fleet renewal programme
- **The Restructuring Loan project**
  - a follow-on investment to support the fleet renewal programme
- **The TC Operation**
  - The formulation, implementation and monitoring of a technical cooperation 'Corporate Governance and Anti-Corruption Measures the client'
- **The Treasury Operation**
  - a set of treasury transactions to purchase and sell the Eurobond issued by the client group in the market
Executive summary

This EvD Operation Evaluation covers an EBRD loan and associated technical cooperation (“TC”) for a wholly state-owned railway (the Client). The loan supported procurement of freight cars for a wagon company, one of two freight subsidiaries. The procurement was completed successfully.

An embedded policy dialogue component of the loan aimed to stimulate fundamental sector reforms needed to consolidate the two freight subsidiaries and lay the basis for network liberalisation. However, progress in critical reform areas, such as tariffs, cross-subsidies, and regulatory capability has been limited and well short of targets. This includes areas identified by the Client as of highest priority. Change has not been induced directly by the EBRD’s policy dialogue but by the market pressure for the Client to be more competitive and support the unification in the former Soviet alliance. The EBRD’s role in this context was to help the Client at the early stage to form key components of the reform.

The attached TC component was intended to assist the Client, at the request of its management, with anti-corruption measures and integrity improvements, which had been flagged by the EBRD’s Board as a concern for a previous Bank loan for the Client. The TC was aimed at the Client’s adoption of a code of conduct and commenced after the wagon procurement was completed. However, the expected corporate governance actions, which were covenanted in the loan agreement, were delayed because authority to take decisions rested not with the Client but rather its primary shareholder, a sovereign wealth fund. The Client eventually adopted the pending Code of Conduct.

As a result of the TC, the consultants provided services in assessing the regulations against best international practices and recommending changes for more transparency and higher standards. The sovereign investor latterly announced it would amend its procurement rules. This is significant progress not only for the Client and its subsidiaries but also key strategic industries and utility enterprises (oil and gas, mining, power, pharmaceutical, civil aviation, and banks) in the country. This report concludes that the TC operation was successful, but requires continuous monitoring.

After this project, the EBRD approved a loan with possibility of conversion into equity, focussed again on encouraging the policy reforms previously covenanted. However, the project and the follow-on project did little to advance the reform agendas.

EvD has nevertheless rated the project as Successful given a visible contribution to the client’s wagon fleet renewal programme and a tangible outcome of the TC operation, which however requires monitoring.

1. Introduction

The project comprised a loan approved to support the country’s railway multi-year wagon fleet renewal programme and a TC operation. The borrower was the freight wagon leasing subsidiary of the state railway, guaranteed by the state railway.

The TC operation was intended to strengthen the corporate governance and anti-corruption measures of the country’s railways and the investment operation was to help the railway’s subsidiary procure freight wagons as part of fleet renewal programme.

The fleet renewal programme was further supported by other EBRD operations during the same year, including:

1) A restructuring loan with possibility to convert into equity
The restructuring loan was intended mainly to advance the EBRD’s policy dialogue for sector and institutional reforms, specifically aiming at the establishment of a freight operating enterprise out of the merger. Once the new enterprise is established, the EBRD could exercise its option to convert the loan into equity in the expectation of a profitable exit in the stock exchange market. This project is linked to an institution building TC for developing a corporate development plan, which is expected to increase the corporate value of the railway group.

2) Treasury transactions to purchase the railway's Eurobonds

The EBRD Treasury Operation consisted of the purchase of the railway group's Eurobond in the secondary market. The EBRD purchased a portion as an anchor investor and sold all of it off in the market during the following months. The proceeds of the corporate bond were used for capital expenditure, mainly wagon procurement.

2. Project ratings

The project was part of a large operation to support the railway’s fleet renewal programme and made a visible contribution to the fleet renewal. The well-defined TC operation delivered a good quality output, which provided a positive effect on the whole group and, less anticipated, a positive upstream impact on the sovereign wealth fund. The project thus delivered a combination of hard (procurement of wagons) and soft (procurement standards and practices) components. Bank handling for the project is assessed as Good while some critical observations are made with regard to the operations with the group.

Considering that the achievement of both the investment and the TC operation are tangible and verified, EvD has rated the project Successful.

Table 1: Ratings summary

<table>
<thead>
<tr>
<th>A state owned railway</th>
<th>OPA ratings</th>
<th>EvD ratings</th>
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</thead>
<tbody>
<tr>
<td>Overall performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Highly successful, successful, partly successful, unsuccessful)</td>
<td>Successful</td>
<td>Successful</td>
</tr>
<tr>
<td>Project relevance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additionality</td>
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<td>Largely verified</td>
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<tr>
<td>(Fully verified, largely verified, partly verified, not verified)</td>
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<td></td>
</tr>
<tr>
<td>Project effectiveness</td>
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<td></td>
</tr>
<tr>
<td>Achievement of operation objectives</td>
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<td>Good</td>
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<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
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<td></td>
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<tr>
<td>Company/Project financial performance</td>
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<td>Good</td>
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<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
<td></td>
<td></td>
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<tr>
<td>Project efficiency</td>
<td></td>
<td></td>
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<tr>
<td>Bank handling</td>
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<td>Good</td>
</tr>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
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<td></td>
</tr>
<tr>
<td>Bank investment performance</td>
<td>Not rated</td>
<td>Satisfactory</td>
</tr>
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</table>
(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)

<table>
<thead>
<tr>
<th>Project impact and sustainability</th>
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<tr>
<td>Transition impact</td>
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</tr>
<tr>
<td>Environmental and social performance</td>
<td>Marginal/Satisfactory</td>
</tr>
<tr>
<td>Extent of environmental and social change</td>
<td>None</td>
</tr>
</tbody>
</table>

3. **Relevance**

3.1. **Rationale**

The operation was in line with the EBRD’s strategy for the country specifically supporting railway sector transformation, and with the Transport Operations Policy promoting railway restructuring and commercialisation. The country strategy noted the railways sector as the first priority. It also identified corruption as a significant issue. The Project was spelled out in a memorandum of understanding signed between the Ministry of Industry and Trade and the EBRD.

3.1.1. **Investment**

At the time of the memorandum of understanding the railway group started implementing a substantial renewal of its aged fleet. It planned to retire old wagons and procure new wagons during the period of the programme. The main driver for the fleet renewal was competition from private operators (wagon owners) mainly in the oil and gas industries, and another state railway. The other state railway was a few years ahead of the client in many respects of modernisation and sector reforms.

At the outset of the project, a decline in the price of wagons was favourable for the client. However a local currency depreciation was compounded by a decline in annual rail freight traffic. The latter occurred for the first time in the client’s history resulting in them seeking cooperation with the EBRD.

The Client found the initial tender response to be more than satisfactory, and its cooperation with the EBRD to be positive. It quickly moved on with the EBRD to the more substantial follow-on investments - the restructuring loan project and the Treasury Operation, which enabled the railway group to benefit directly and indirectly from the sizeable facility.

3.1.2. **TC Operation**

The stand-alone TC operation has its own background. During the pre-board EBRD meeting for an earlier communication infrastructure project with the railway, Directors’ concerns centred acutely on corruption within the group. Despite that project being approved, the concerns remained.

When a high profile dialogue was later held, a higher standard of governance was discussed. The dialogue led to the state railway’s top management requesting help in formulating anti-corruption measures. This was seen as an opportunity for the EBRD to demonstrate a value-added to the client, with whom major multi-lateral development banks had been longing to do business. The signed memorandum of understanding included cooperation on corporate governance and anti-corruption measures. Within two months, TC funding was arranged. The consultancy services were carried out a couple of years later.
3.2. Additionality

Table 1: Additionality ratings

<table>
<thead>
<tr>
<th>Additionality</th>
<th>OPA</th>
<th>EvD</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Fully verified, largely verified, partly verified, not verified)</td>
<td>Largely verified</td>
<td>Largely verified</td>
</tr>
</tbody>
</table>

The investment's financial additionality was debatable as the Client had always had access to the international financial markets. Ever since its foundation, the Client has been able to source necessary funds in the capital market. The first corporate bond was issued a number of years ago, underpinned by an EBRD purchase. The bond was rated as investment grade by the credit agencies (BB+/BB-/B1) and it has been rated more highly than at first issue ever since. The Board document cited the Client Group's financial needs in the context of difficulty in raising funds in the post-crisis capital markets.

The one of the Client's bonds was maturing, and the Client Group was also servicing a Eurobond. Restructuring the hard currency debt was necessary to reduce the financial burden.

A further bond issue needed an anchor investor to prop up market sentiment and the EBRD achieved this successfully. The operations with the EBRD successfully filled the Client Group's financing gap at difficult moments.

Nevertheless, any other IFI or Chinese source could have provided the same benefit, and some of them had been keen about the opportunity to cooperate with the Client. Therefore, the financial additionality was partly verified.

The appraisal Board document also reminded the team of the EBRD's ability to support sector reform through policy dialogue and mobilisation of technical cooperation funding for consulting services. The conditionality with regard to the sector reform actions was incorporated in the guarantee agreement with the Client, however, had no direct linkages with the subsidiary's wagon procurement. A systemic link between a stated additionality and the core project objective was missing at ex-ante, and not verified at ex-post given the waived covenants.

A large part of the EBRD's additionality lay, in effect, in its value-added of creating an anti-corruption culture and laying down an action plan in the Client. The TC Operation constituted strong additionality in the design and functionality of the Project. This was not mentioned at appraisal.

4. Effectiveness

Table 2: Effectiveness ratings

<table>
<thead>
<tr>
<th>Achievement of objectives</th>
<th>OPA</th>
<th>EvD</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
<td>Good</td>
<td>Good</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Company financial performance</th>
<th>OPA</th>
<th>EvD</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
<td>Good</td>
<td>Good</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project financial performance</th>
<th>OPA</th>
<th>EvD</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
<td>Good</td>
<td>Good</td>
</tr>
</tbody>
</table>
4.1. What were the objectives and to what extent were they achieved?

The Project has two components (i) physical component; and (ii) policy dialogue component. The respective objectives are assessed as below.

4.1.1. Replacing part of the wagon fleet

The sole operational objective of the physical component at appraisal was to procure new wagons. EvD assessed this objective in the context of the fleet renewal programme. The programme is an extensive multi-year exercise ultimately aiming to provide several thousand brand-new, more durable wagons - nearly the half of the fleet – thereby reducing the average fleet age.

The fleet renewal programme, while still on-going, is nearly half way to being accomplished. The procurement, using the EBRD loans and the Eurobond, was completed. At the time of writing the fleet renewal programme had renewed a little over a tenth of the total fleet and the EBRD funding (including the Loan, the Restructuring Loan and the Eurobond purchase) had contributed to half of this.

The combination of various types of wagons and difference of prices and tender timing resulted in a minor deviation of the total number of wagons from the appraisal estimate. The actual number of wagons procured from the EBRD loans was slightly lower than planned at appraisal.

Overall the objective has been achieved and the EBRD made a tangible contribution to the fleet renewal programme.

4.1.2. Facilitate corporate governance and anti-corruption measures

The Client often drew corruption concerns and its practices were widely seen as non-transparent. Despite introduction of some internal improvements, there was still some divergence from international standards.

The objective of the TC operation was to help implement anti-corruption procedures and control functions in the areas of procurement, cash management and expenditure approvals and establish an internal audit function. The aim was to hire a team of mainly international consultants in these areas. Sixteen months per person of services had been planned at the onset, which was later modified to a lump-sum basis delivery.

The TC was well designed with a focused objective with specific outputs, among which the adoption of the Code of Conduct was set as a measurable goal.

The consultants found a gap in the definition of ‘corruption’ affecting the implementation of a Code of Conduct which needed to be addressed. In the country concerned, the concept of ‘corruption’ is associated with ‘bribery’ and the term ‘bribery’ is only applicable to high-ranking people - other corrupt practice is classified as ‘fraud’. They also discovered a number of issues in the Client’s procurement procedures. Training of key personnel was conducted in order to show international standard practice and its benefits. Analysis was provided and the presentation of recommendations was carried out. The final presentation was made to top management and the company’s board of directors. The president of the company appreciated the report and presentation and acknowledged the recommendations.

However, the adoption of the Code of Conduct (Code of Ethics) was stalled since the Client had to seek the sovereign wealth fund investor’s guidance and approval on the recommendations to change in corporate rules and procedures. The Transition Impact Monitoring System (“TIMS”) showed the delay in achieving this transition benchmark.
The Client eventually advised the EBRD that the Code of Conduct had been adopted. This objective is considered achieved. The success of the TC operation was due to the EBRD assisting in an area where the Client had little expertise and the focus and specificity in design and implementation.

The sovereign investor apparently backed the consultants’ report. With their support, it is hoped that the recommended measures will be steadily implemented (see also Section 5.3.2).

4.2. Project/company financial performance

The renewal of the wagon fleet will eventually increase the freight transportation capacity because of the improved efficiency in loading and unloading and increased wagon turnaround.

The economic and physical life of a freight wagon is usually estimated at 20 years and 30 years, respectively. At appraisal, the Client was planning to retire several thousand wagons over a two year period. The replacement of wagons has reduced the average age of the fleet from 22 years (baseline) to about 17 years as an outcome. Also the average economic life of the fleet has been prolonged as a new wagon has a longer life of up to 22 years.

The actual project benefits are derived mainly from (i) reduced maintenance frequency and cost (labour and material); and (ii) improved safety. As incidental benefits, the train operation planning staff confirmed faster loading/unloading (shortened from 1.5 hours to 30 minutes), fewer breakages and more durability that withstands running at 100 km per hour if wagon is empty.

The Client has invested in a GPS-based wagon tracking system for the end-to-end visibility of goods. The installation will be conducted over two years for gondola wagons.

The fleet has been effectively upgraded while the benefit of the fleet renewal programme has not been quantified

The Client Group, with over one hundred thousand employees, is a vertically and horizontally integrated unbundled railway enterprise. Issues of bonds in the capital market are centralised in a European based finance company but the intra-group structure is complex with a number of unstreamlined subsidiaries creating unclear systemic links. The Client is undergoing a group reorganisation (according to the Government-approved development strategy to 2020). It is nevertheless clear that the Client takes the final financial risk for all group companies as stated in the prospectus of its debt securities.

The Client's share in the freight wagons is about 50 per cent in the country. The remaining wagons are owned and leased by private sector wagon owners and leasing companies. While the deregulated pricing for privately-owned wagon could be more advantageous than the Client's rents, the parent's patronage and the regular increase of wagon rents has secured its financial viability. Freight volume has steadily risen over a 10 year period, whilst passenger volume remains steady.

EBRD’s Credit Department has regularly updated the financial status of the client. The external credit agency (Fitch) recently affirmed BBB stable rating. This rating is equivalent to EBRD’s '4' or Good. This level of credit standing of the guarantor raises little concern about the repayment of the loans, Therefore this report does not repeat their analyses but focus on the operational aspect in their financials, which are not covered by the routine credit analyses.

More than 50 per cent of freight transportation (in terms of ton-km) is carried by the railways. There was a steady recovery in transportation volume after a drop during the financial crisis. In the past three years, freight revenues have increased by 10 per cent on average, of which 5 per cent is due to the volume increase and the other half to tariff increases in real terms. Passenger revenues have increased in real
terms owing solely to the marginally growing passenger volume, as the unit passenger revenue (per person per kilometre) has remained at the same level.

The Client has been profitable and its return on assets is around at least 5 per cent, which is good for a state-owned railway enterprise.

As the OPA indicated that 'the Client’s financial performance will be further improving on the back of increased tariffs on freight transportation and growing freight turnover, which goes hand in hand with the overall economic growth'.

The Client’s financial performance is good. There are nevertheless some risk factors (see Section 6 Transition Impact) which signal the need for institutional and sector reforms.

- Inter-modal and intra-modal competition: Modal split shows growing pipelines and road traffic in recent years. Increasing competition from the deregulated competitors is also a threat to the Client Group.
- Cross-subsidisation: On average only 30 per cent of passenger coaches are occupied. The Client admits that the passenger transportation is loss making and that its tariffs are set at affordable but commercially unviable level because of public service duty. Profit-making freight services make up their losses.
- Tariff issues: The Client’s freight tariffs to shippers and wagon rent are both regulated by an agency for monopolies. The agency has defended the conventional Soviet based tariff regime, which progressively loses its rationale in a commercial environment.

4.3. Bank handling

<table>
<thead>
<tr>
<th>Table 2: Efficiency ratings</th>
<th>OPA</th>
<th>EvD</th>
</tr>
</thead>
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<tr>
<td>Bank handling</td>
<td>Good</td>
<td>Good</td>
</tr>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank investment performance</td>
<td>Not rated</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>(Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)</td>
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</table>

The Operation team (including members of Credit, Office of the General Counsel, Operation Administration Department, Office of the Chief Economist, Procurement and the Environment and Sustainability Department) formulated, structured, implemented and monitored the project dealing with the large number of adjustments and changes in a professional manner. The OPA was of good quality and objective. The Resident Office played a key role at every stage of the project and provided comprehensive support to the evaluation exercise.

The quality of the TC Operation, with clear specificity in design and the management of the consulting services deserves a particular mention. Therefore EvD rated Bank Handling for the Project as Good.

However, EvD also identified few issues below about the transactions with the Group.

4.3.1. The TC cost sharing

The Client is a wealthy organisation with no affordability issues. However, the recovery of the TC cost was not arranged for the TC Operation. Given the background to the origination of the TC the TC cost could have been recovered from the Client.
The Operation team for the Restructuring Loan project responded to the advisors to the Directors about possibility of TC cost sharing that cost sharing was not envisaged.

EvD is of the view that publicly owned companies were exempted from cost sharing mainly because of their generally-perceived affordability. Therefore using the Policy to justify the exemption of the Client seems to be against the spirit of the Policy itself.

4.3.2. Misplaced confidence in sector reforms

At appraisal there was scepticism among the Board about the sector reform commitment and it increased during the Board meeting for the restructuring loan project. Three Directors abstained during the Board considerations for the reasons associated with reform conditionality.

During the loan negotiations the Client expressed that they would be unable to fulfil those sector reform covenants. Therefore, the Operation team was aware of likely delays in reform actions thus breaches of the covenants, but proceeded with signing.

Not surprisingly there were many occasions of lifting the loan conditions during implementations. Covenanted reform milestones were breached in six months of the signing of each loan and routinely waived or postponed.

Even though there was a time constraint, it is not a sound practice to sign the loan, of which conditions are known not to be honoured by the borrower. The Operation team explained that they opted to set tight reform milestones and lever the Client toward the covenanted transition impact objectives.

In reality an overestimation of the client’s commitment to reform actions made the projects high-maintenance transactions.

4.3.3. High maintenance transactions

Breaches of negative pledge occurred very frequently. The above waiver process for the reform milestones added an extra burden on a number of consents to the borrower’s financial activities.

In fact the project and the restructuring loan resulted in thirty and forty waivers/amendments/consents, respectively, which are significantly more than those for usual lending operations.

4.4. Investment performance

Returns on the investment operations are considered satisfactory.

There was a concern raised about the level of margin for the loan during the internal approval process. Given the then LIBOR and swap rate, the level of margin was very favourable for the Client. Further the margin was reduced as requested by them a year after the loan signing. It was justified to reflect the Group’s improved credit standing in the market. Nevertheless the actual and estimated interest income has covered and is expected to cover the direct and indirect costs. The EBRD made a considerable gross profit from the Treasury Operation.
5. Impact and sustainability

Table 3: Ratings of transition, environmental and social impacts

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<th>Realised transition impact</th>
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<th>EvD</th>
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<td>Marginal</td>
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<th>EvD</th>
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<tbody>
<tr>
<td>(Outstanding, substantial, some, none/negative)</td>
<td>None</td>
<td>None</td>
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</table>

5.1. Expectations for transition at approval

The EBRD expected (i) sector reforms with a focus on the establishment of a freight operating company (“Freight Operator”) and associated actions; and (ii) institutional reforms aimed at improving the Group's corporate governance and ethical norms, staff conduct, and anti-corruption measures.

At appraisal, the project justification was apparently strengthened by the transition agendas that the EBRD intended to address. To achieve the transition objectives, the EBRD applied:

i) covenants in the guarantee agreement for the above

ii) sector reform actions; and

iii) covenants in the guarantee agreement and the grant-financed TC operation for the anti-corruption actions.

However, there was little logical and systemic connection between the procurement of wagons by the Client (the operational objective – the first priority project for the Client) and the expected transition impact of the project - institutional and sector reforms - to be undertaken. It was not clear how the proposed reforms and the anti-corruption measures could benefit the wagons. This appeared to be a weak ring of the project design chain.
5.2. Transition impact measured by the Transition Impact Monitoring System

Table 4: Ex post transition impact analysis

<table>
<thead>
<tr>
<th>TI checklist categories</th>
<th>Short-term verified impact</th>
<th>Long-term TI potential</th>
<th>Risk to potential TI</th>
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<tbody>
<tr>
<td>Step I: change by the project at corporate level</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Private ownership</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Skill transfers</td>
<td>Good</td>
<td>Good</td>
<td>High</td>
</tr>
<tr>
<td>6 Demonstration effects</td>
<td>Good</td>
<td>Good</td>
<td>High</td>
</tr>
<tr>
<td>7 New standards for business conduct</td>
<td>Good</td>
<td>Good</td>
<td>High</td>
</tr>
<tr>
<td>The client has complied with rigid covenants</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Step II: transition impact at the level of the industry and the economy as a whole</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Competition</td>
<td>Satisfactory</td>
<td>Good</td>
<td>High</td>
</tr>
<tr>
<td>2 Market expansion</td>
<td>Satisfactory</td>
<td>Good</td>
<td>Medium</td>
</tr>
<tr>
<td>3 Private ownership</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Frameworks for markets</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>High</td>
</tr>
<tr>
<td>5 Skills transfers</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Demonstration effects</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
<td>Medium</td>
</tr>
<tr>
<td>7 New standards for business conduct</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Summary of verified, potential and risk ratings</td>
<td>Satisfactory</td>
<td>Good</td>
<td>High</td>
</tr>
<tr>
<td>Overall transition impact:</td>
<td>Satisfactory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Short term verified impact: (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)
Long term TI potential: (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)
Risk to Potential TI: (Excessive, high, medium, low)
Overall TI: (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)

The Transition Impact Monitoring System ("TIMS") has monitored the progress against benchmarks in detail and the rating of the latest TIMS report stood at Good for transition potential but at High risk.

There were two components in transition potential:

- Supported by the large amount of the investments, the project pursued rather a specific sector transition objective — that is the establishment of the freight operator. The ultimate goal is to liberalise the network. It was the right focus for the country’s railways, which carry over half of freight traffic in modal split. TIMS benchmarks were developed sequentially and were comprehensively covenanted on each milestone. The preparatory actions such as TIMS benchmarks 2.1 and 2.3 were taken. However, the bottleneck issue (Section 5.3.1) hindered further progress such as benchmarks 1.2 - 1.4, 2.2 and 3.1. Thus the benchmarks are yet to be fulfilled while the latest development is encouraging (Section 5.3.1) and requires monitoring.
Corporate governance and anticorruption measures: The Client's actions were slow during the TIMS monitoring period. TIMS pointed out the constraints imposed on delivering the outcome when the sovereign investor was responsible for making decisions. However, at the time of writing the client has become more engaged, receiving a supportive signal from the sovereign investor as described in this report. Measures have been initiated and developed within the Group, although they are still at an early stage. They were also partly facilitated by exogenous factors such as the move towards acceding to the World Trade Organisation. The difference in ratings reflects the latest action taken by the sovereign investor to change the regulations, which EvD has included.

Table 5: Transition impact benchmarks (ratings from the OPA)

<table>
<thead>
<tr>
<th>Objective</th>
<th>Benchmark (target month/year)</th>
<th>Status (achieved, partly achieved, not achieved)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Commercialisation</td>
<td>1.1. Action plan for establishing freight company</td>
<td>Achieved</td>
</tr>
<tr>
<td></td>
<td>1.2 Legal registration of freight company</td>
<td>Not achieved (postponed to 2014)</td>
</tr>
<tr>
<td></td>
<td>1.3 Creation of freight company as a national carrier with a separate balance sheet</td>
<td>Not achieved (postponed to 2014)</td>
</tr>
<tr>
<td></td>
<td>1.4 Adoption of the corporate development programme of the freight company</td>
<td>Not achieved (postponed to 2014)</td>
</tr>
<tr>
<td>2. Improvement of the railway sector regulation</td>
<td>2.1. Creation of a working group for the implementation of the sector restructuring</td>
<td>Achieved</td>
</tr>
<tr>
<td></td>
<td>2.2. Working Group to submit a request to the government to establish an independent railway regulatory authority</td>
<td>Not achieved</td>
</tr>
<tr>
<td></td>
<td>2.3 Listing the initiatives to improve the legal framework in the railway sector</td>
<td>Achieved</td>
</tr>
<tr>
<td>3. Greater competition in the railway sector</td>
<td>3.1 Allowing third-party operators (privately owning the rolling stock) a non-discriminatory access to the network infrastructure</td>
<td>Not achieved (postponed to 2014)</td>
</tr>
<tr>
<td>4. Setting standards for corporate governance</td>
<td>4.1 Adoption of the anti-corruption measures</td>
<td>Achieved</td>
</tr>
<tr>
<td></td>
<td>4.2 Implementation of the anti-corruption measures</td>
<td>Achieved (on-going)</td>
</tr>
</tbody>
</table>

5.3. EvD's assessment of transition impact

Overall transition impact is rated as Satisfactory, which is a combination of Good transition potential and Satisfactory verified impact.

5.3.1. Sector reform component

EvD assessed transition impact on the railway sector as Satisfactory as progress was made. The follow-on investment (the restructuring loan project) has not worked as an additional leverage in this area of policy dialogue.

All sector transition benchmarks for sector reforms related to the establishment of a freight operating company. In order to achieve this, the Client plans to merge its two subsidiaries to create a national freight operator. However, the proposed freight operator needs an enabling framework under which it can operate, before it can be established.

The enabling sector framework included:
Tariff reforms by changing the tariff setting mechanism which was based on the Soviet-style average cost block. The tariff issue has long been a sticking point in a power struggle among several sector stakeholders. It was considered necessary to introduce more transparency and eliminate distortion in the partly competitive market.

Separating passenger services from freight transportation, removing the freight operations’ subsidy of the chronic passenger operation losses. This requires the government to be firmly committed to subsidising the passenger services. However, this agenda has not moved smoothly in the face of the Ministry of Transport's reluctance to secure the budget annually to cover the losses.

Separating operations from infrastructure, which requires an independent sector regulator to ensure the safety and quality of rail operations and maintenance of infrastructure in a sustainable manner; this body will be accountable for the track access charge and will lead to non-discriminatory access to the network for rail operators. However, slowly-progressing tariff reforms and the separation of passenger services, and the government-led conventional capital investment norms hinder significant steps forward.

Closure of loss-making lines and disposal of social assets (non-core businesses) such as hospitals, schools, technical institutes and ancillary services, which requires collaboration with the government and the local authorities. However, the negotiations are not easy.

The Client stated that, among these conditions, tariff reform was the most pressing, for the reasons outlined below. The capacity of the price regulator appeared to be an impediment to the reform actions.

Freight operations are carried out by two dominant players, one of which is the Client. The other was privatised recently. Their respective market shares are two to one. While tariffs of the Client are subject to the price regulator, the other player enjoys the deregulated tariffs norms as a private sector player. Shippers preferred the private sector player's market-based tariffs to those offered by the Client’s. The latter maintains the old tariff structure and the government's guided norms for certain commodities. Most recently one fifth of the Client’s wagons were loaded outside the country to benefit from the deregulated pricing.

A new tariff structure was under review for a decade without being approved, and became a true bottleneck in the sector reforms whilst a neighbouring country had made headway in implementing reforms. The EBRD's dialogue regularly touched upon tariff reforms but resulted mainly in occasional increases to capture inflation without substantial change to the setting mechanism. Market pressure did not seem to impact on the price regulator and the Client struggled.

The price regulator eventually removed the disparity and approved a single tariff for export, import and domestic freight. Shortly afterwards both companies signed a memorandum for sound competition and cooperation.

Recently the country signed a cooperation agreement with three neighbouring countries to specialise in containerised cargo transportation. The cooperation will include joint investment in associated infrastructure. This has marked the commencement of a new period for the railways.

The above moves in the railway sector suggest that the most prominent drive for transition is regional competition, which was created spontaneously in the market.

TIMS captures the impact made by exogenous factors (not induced by the EBRD) and rates accordingly. This report follows the same approach and considers that the transition in the sector, driven by the Client
and surrounds, is Satisfactory. To date the EBRD's contribution to the sector reforms has been limited but there are many more challenging agendas still in the monitoring list. Risk to transition potential is considered High.

5.3.2. **Institutional reform component**

EvD rated transition impact on the Group as Good owing chiefly to the TC Operation.

In the past, the Client did not particularly need or seek the assistance of multi-lateral development banks. Limited interaction and exposure did not help the Client change their old working norms and rules from the Soviet era.

**Input:**

The TC operation was a novelty in the country. During the 10-month service period, the experienced international and local consultants overcame a few obstacles and performed the required tasks in a flexible and responsive fashion. The obstacles included the Client's unfamiliarity with and scepticism about the aim of the consulting services, an undefined counterpart unit within the Client at the beginning (as a suitable unit did not exist), and the uncertain buy-in of its management.

While conducting the training sessions, the consultants increasingly gained the key personnel's understanding of (i) the need for strong leadership to combat corruption; (ii) internal and external perception of 'corruption'; (iii) risk resulting from corruption; (iv) frontline international practice (consistent with the United Nations and OECD conventions); and (v) strategy and specific actions against corruption.

Soon a few executives, including one of the Client's vice-presidents, a leading role and a unit equivalent to internal audit started working enthusiastically to coordinate and plan with the consultants.

**Output:**

The major findings included:

- The younger generation opposes corrupt practice and was hopeful about the Client group's anti-corruption actions. The consultants recommended a corporate-wide anti-corruption campaign, which included a clear statement from the company’s president on combatting corruption and a card-sized anti-corruption statement to be distributed to all group employees.

- All staff needed to develop a fair understanding of corruption, transparency and integrity in international terms. An anti-fraud manual in both English and local languages was prepared.

- Corruption cases in the company (which are regarded as 'frauds' and not 'corruption') were surprisingly fewer than generally perceived.

- A thorough review of procurement rules and practice revealed potentially significant issues and a large divergence from international practice, caused by the sovereign investor's procurement guidelines. Controlling more than a dozen state industries, the guidelines had to be general, broad, non-specific and non-technical, which allowed the Client to develop its own interpretation and rules. And those downstream rules were not in line with international standards due mainly to insufficient exposure to international best practice. It induced the risk of non-transparent or arbitrary practice. Thorough and specific recommendations to revise the rules were prepared.

- A whistle-blower mechanism, which originated from a 'Hot Line' proposed by the president of the company, was of limited use when corrupt practices occurred in remote sites such as a station or depot since doubts about anonymity prevailed in the organisation. The Client's corporate culture and staff awareness are yet to develop sufficiently to make it more effective.
Outcome:

The analysis and recommendations were presented to the Client's management and board members. The board and management were supportive, although some resistance from the procurement department was noted. The president of the company valued the recommendations highly and agreed to consider them subject to the sovereign investor's endorsement. The consultants completed their assignment.

The consultants' concerns related to the sustainability of the anti-corruption programme. The consultants trained the (potential) trainers but the continuation of training after completion of the TC was uncertain. Management commitment following the departure of the consultants was another source of concern.

The Client started implementing some recommendations by amending the company's procurement rules. The training continued regularly without consultants. The unit equivalent to internal audit continued working on the recommendations wherever immediately actionable. The company organised a meeting of group employees in order to discuss the procurement practice, raise issues and clarify the interpretation of the rules associated with the sovereign investor's procurement guidelines. During the Operation Evaluation mission, the Client issued a letter to the EBRD that it had adopted the pending Code of Conduct.

The consultants' report and recommendations interested key executives close to the office of the sovereign investor's president, which resulted in management reviewing the report. They wished to learn more about international practice particularly in procurement and then engaged similar consulting services for themselves to review their procurement rules, which could affect a number of the strategic industries and utilities in the country.

The TC operation, indirectly but ultimately, resulted in adoption of new procurement rules. The sovereign investor had reviewed the study of comparable analysis with the best international practice, and in view of the country's accession to the World Trade Organisation they decided to introduce more competitive, fairer and transparent procurement procedures, including an e-procurement system. The expected impact of the changes would be better quality goods and services at the competitive prices. The magnitude of the potential impact should be large, given they purchase a large number of goods and services annually.

However, risk to transition potential is again High.

- The implementation of the Code of Conduct within the group requires close monitoring and it needs to permeate into all group companies. There still is a high degree of uncertainty regarding building the anti-corruption culture (related recommendations are drawn in Section 6.2).

- The impact on the sovereign investor and subsidiary industries and large enterprises also may need attention as to how their practice changes, although this is beyond the project's outreach.

5.4. Environmental and social impacts

The operation team rated the environmental impact Marginal in the self-assessment - mainly due to the lack of commitment from the client to the environmental and social development aspects. EvD concurs with the Marginal rating in this area.

The environmental and social due diligence for the project confirmed that the Client had adequate corporate level policies and management systems for environment, occupational health and safety, quality control and human resources. However, the due diligence for the restructuring loan project uncovered that ISO14001 only applied to the Client's administrative headquarters and that the wagon depots, particularly outside the main city, were sub-standard and required much attention. The restructuring loan project took
this into account and included the depots and workshops in the implementation and monitoring coverage of the environmental and social action plan.

The Environment and Sustainability Department reported difficulties with the client and commented that the coordination and communications with and within the Client were poor, pointing out low awareness of the environmental, social and health and safety issues.

5.4.1. Environmental and social performance

While the environmental issue associated with the procurement of wagons was insignificant, the loan agreement required the Client to implement the EBRD’s environmental and social action plan (without action in the depots). However, the operation team found the company’s response, actions and reporting norms rather disappointing. In the restructuring loan project, more actions were added, particularly for handing waste, lubricant and hazardous materials at the client’s depots and workshops. The dialogue with the client to improve awareness and environmental and social measures appears to be enduring.

5.4.2. Extent of environmental and social change

The physical impact of the fleet renewal is positive, provided that the retired wagons have been scrapped or disposed of according to the required procedures, which appears to be the case with the Client. On the other hand, the environmental and social action plan has not resulted in any visible progress yet. Overall the changes are considered insignificant.

6. Conclusions

6.1. Findings

6.1.1. Minimal reform progress in the country’s railway sector

The EBRD provided the Company with technical assistance early on regarding railways freight tariffs, infrastructure access and sector regulation, and the recommendations from this were presented to the then management. The enabling sector framework has been discussed over a decade among the key parties of the railway sector including the Client, Ministry of Transport, sovereign investor and regulator, and also in the EBRD’s policy dialogue. Nevertheless, and despite consistent optimism about impending reform, significant reform has not progressed, either hoped or expected. Transition milestones have consistently been postponed and formal covenants have not been fulfilled.

Decision making about the railway sector appears to be malfunctioning – involving various parties inside and outside the country – economic or political interests, or the Eurasian Economic Community or the European Union. Reform commitments of the Client alone do not transform the sector and the outcome of the EBRD’s facilitation of dialogues among reform stakeholders and neighbouring railways emerges slowly and thus far remains limited.

Even being covenanted, the sector reform agendas did not progress as expected. It was the pressure from a deregulated competitor and the threat in the market, which moved the price regulator to dissolve the tariff disparity and the Ministry of Transport to approve a joint venture.

In its development strategy, the Client suggests that the current model of industry’s regulation and tariff control policies do not satisfy the long-term consumer interests and the program for development for the railway transport reform, which is aimed at achieving an optimal system of railway transport functioning, must be brought to its fruition as per the current strategic plan.
MDBs saw similar statements in the previous strategic plan in early days. However, this time the Client recognises the power and pressure of the market that is developing much faster than a decade ago. The way of supporting the sector reforms might be worth reconsideration.

The EBRD has approved a further loan to a private sector wagon leasing company in the country. It will support the rapidly growing private sector wagon leasing companies to compete with this Client. This should be considered an effective way for the EBRD to promote transition in the freight operations as it creates competition to the Client Group.

The Client is responsive to the market and creating competition and thus creating the market environment could be a more effective way than simply maintaining an enduring policy dialogue between the Ministry and the Client.

6.1.2. **Linkages between investment and TC operations**

This evaluation has been undertaken in accordance with an approach paper. As indicated in the approach paper, one of the aims of the evaluation was to assess the effectiveness of linkages between investment and TC operations; was the TC operation designed to effectively benefit the physical investment component and/or policy dialogue? Was the link between the TC operation and investment strong and systemic enough to achieve the project’s overarching objective?

The issue of the conventional project structure (a combination of investment and a TC) is the weak complementarity and relevance of the TC operation to the physical component. If there were no systemic linkage between the TC outcome and the physical component, the TC would be a mere transition impact accessory to justify the investment.

The anti-corruption TC operation resulted in a thorough review of the company’s procurement practice, which the wagons are subject to. Therefore the fleet will benefit from the improved rules and practice. The Group’s governance and practice, if improved, will create more corporate value when it becomes a freight operator, of which EBRD might or might not be a shareholder. A seemingly remote linkage of rationale between the TC operation for the company’s fleet was filled in when the expected TC outcome was achieved. The TC proved its relevance to the investment.

The operation is a good example of a successful hybrid (a combination of a physical component and a TC of stand-alone nature) project in the public sector infrastructure.

6.1.3. **The EBRD’s financial addiitionality**

The hardest year for the Client has passed. After the restructuring loan project, the Group issued the Eurobond. This bond issue could have improved the asset-liability structure. The EBRD’s financial addiitionality could again be minimal, if any and its leverage on policy dialogue could diminish if the Client returns to its former robust financial position.

Extra ingenuity in design and functionality would be necessary for any follow-on project with the Client Group in order to strengthen the rationale.

6.2. **Recommendations**

6.2.1. **TC sustainability and Reputational risk of potential fate sharing**

The positive outcome of the TC Operation is recognised and the sustainability of the TC outcome is equally important for the EBRD. The Restructuring project includes an option to convert some portion of the loan into equity when certain conditions – to be defined - are met. If the EBRD were to become a shareholder of the Client's freight operator, the EBRD would be directly exposed to reputational damages.
from corrupt conduct. The reputational risk for a shareholder of a former Group company, rather than a creditor, could be considerably higher. EvD solicits a caution to this matter given the degree of risk that the EBRD would take for an indefinite time.

Despite the Client’s current unwillingness for the EBRD’s shareholding, the situation might change in future.

Integrity and anti-corruption training seem to have become more routine. However, sustainability is likely something that will require continuing effort.

It is recommended that:

As mentioned in Section 4.3 Bank Handling, the conversion of the outstanding loan into equity require a full proposal (President’s Recommendation) afresh for the Board approval.

The project proposal for any further project with the Client be accompanied by:

- a full update and analysis of the implementation of the Code of Conduct and anti-corruption measures with quantitative and qualitative supporting data wherever possible. The information will include (i) output of training (in-house and by external consultants); (ii) trend of the number and types of incidents violating the Code of Conduct; (iii) impact of the revised procurement rules and practice; and (iv) highlights of the internal audit’s activities and achievements including whistle blowers.

This could also be an opportunity for the EBRD to provide a systematic assessment of the degree to which the core elements of integrity and anti-corruption training supported by the EBRD have been internalised, extended and mainstreamed by the Client.

- Analysis of the progress of reform milestones

The operation team has provided the Board with the reform progress updates prior to the Board considerations. However, during the Board considerations for the latest project, some members unequivocally requested an update of the outcome of the past TC operations for sector reforms and institution building as the Board document did not present such information sufficiently. This confirms the felt need for more useful information for decision making. Such information should include (i) the Team’s analysis of impediments as to why the milestone was missed or postponed; and (ii) the Team’s specific plan as to how they could tackle the unfulfilled agendas to break through the situation.
Annex 1: Management comments

Management reviewed the EvD Operation Evaluation with interest and agrees with the overall assessment of the project as being Successful. Management has the following comments in response to the findings and recommendations of the report for EvD's consideration:

Transition Impact Rating

Management has significant reservations on EvD's assessment of the project's verified transition impact (TI) as Satisfactory, for the following reasons:

Timing of the assessment: One has to take into account that railway sector reform takes time, even in the most advanced countries. The project targets systemic change in one of the largest state-owned companies in the country where the social dimensions and the implications of the planned reforms - including affordability and labour issues - are significant. Considering the expected sector reform time horizon (over 10 years), it may be premature to evaluate the success of this complex operation only 3 years after signing. Management agrees that the risk to transition remains high and continuous dialogue is required during implementation; it also agrees that the long-term transition impact potential of the project remains Good.

Key transition objectives of the project: the key transition objectives of this particular transaction differ from those assessed by EvD in the report. The key transition objectives at the time of appraisal and Board approval were: (i) the establishment of freight; (ii) improvements in the railways sector regulatory and legal framework, including steps towards the establishment of an independent railway regulator; (iii) the introduction of non-discriminatory track access; and (iv) the formulation and adoption of an anti-corruption programme. In this ex-post evaluation, EvD appears to focus only on (i) and (iv) [See section 5.1] while adding new objectives, such as tariff reform and the separation of passenger operations.

Transition impact progress achieved so far

Management acknowledges that there have been delays in the corporatisation process and associated institutional changes as a formal Action Plan was adopted by the government only later. However, the report could/should acknowledge the fact that the formal adoption of a railways sector reform plan has been a major achievement and one where the Bank played a significant role. We thus disagree with the statement that the EBRD's contribution to sector reform and policy dialogue has been limited [Section 5.3.1, last paragraph; and Section 6.1.1]. Also, as part of the policy dialogue efforts, the Bank has launched a new TC on infrastructure regulation & tariff policy” to work with the price regulator and the Ministry of Economy as well as the sovereign investor. The TC will cover sector-wide tariff issues as well as governance. Since the adoption of the railways reform action plan, progress has been made without major delays. Moreover, intermediate steps (such as asset consolidation and accounting separation) have already taken place before the formal establishment of the freight company. Also, as rightly pointed out by EvD, improvements in governance and the adoption of anti-corruption measures are very important steps for the company. Because of the company's scope and role in the railways sector, progress achieved to date may deserve a better overall transition impact rating, especially when taking into account the difficult reform environment that may explain some of the delays in implementation.
Transition impact on the railway sector

EvD’s assessment of the achieved transition impact on the railways sector seems to be weighted down to Satisfactory because of the lack of an enabling sector framework and specific sector reforms [see 4 bullet points in Section 5.3.1]. We concur with EvD that the capacity of the sector regulator has been an impediment to tariff reform. However, one has to take into account the following when assessing this project and the associated regulatory framework:

- Tariff reform: one of the key aims of the project, that is, the establishment of a freight company, was to partly liberalise the sector and allow for more competition – that is move from a regulated industry to a competitive industry. Tariff regulation by the regulator in this context (the freight industry) would not be appropriate or necessary and would be contrary to the global industry standards.

- Separating passenger services from freight transportation: this was agreed with the authorities and spelled out in the adopted Railway Sector Action Plan and thanks to the policy dialogue efforts by the Bank.

- Separation of operations from infrastructure: this was agreed with the authorities and spelled out in the adopted Railways Reform Action Plan thanks to the policy dialogue efforts by the Bank.

- Closure of loss-making lines: unlike European railway networks, rail networks in the country are rather simple and most lines are profitable. Thus this may not be a priority for sector reform.

Justification for EvD overall transition impact rating

The reasons for the overall transition impact rating of Satisfactory are unclear to management. EvD acknowledges that the project has a long-term Good transition impact potential overall. It seems that this may be due to the weighting methodology between the short-term verified impact and the long-term transition impact potential ratings. EvD seems to assign a higher weight on the realised transition impact and put a lower weight on the potential transition impact. While this may be more understandable for private sector projects, it may not be appropriate for large/public sector projects, as to achieve the expected transition impact it may take a significantly longer time and require continuous policy dialogue efforts.

Key findings [section 6.1.1]

While competition, especially in freight operations, is positive for transition, management disagrees with EvD’s assessment that this is a more effective way of triggering change and a response by the company than engaging in policy dialogue with the ministry and the Client. Both are needed and without the Bank’s efforts to engage in policy dialogue with the company and the authorities we would have not been able to make progress on the sector reform Action Plan that was a pre-condition for the operational restructuring, commercialisation and the creation of a freight company.

Environmental and Social Impacts

EvD’s rating of the extent of environmental and social change is None. The company agreed to, and hired consultants to develop an environmental and health and safety management system in its wagon repair depots. This was largely possible due to the EBRD’s intensive dialogue with the company. The company also developed a retrenchment plan and a grievance mechanism, which is also due to the EBRD’s requirements.
EvD specialists are encouraged to get in touch early with the Environment & Sustainability Department to discuss any findings and documents pertinent to the transaction. Direct contact with ESD at any stage of the report preparation would allow EvD to be abreast of the most recent developments with regard to environmental and social matters of the project.

**Timing for Signing**

Management questions the implication that the loan agreement was signed before all necessary conditions were met because of time pressure. Management emphasises that a signing can only happen when both the Bank and the client are ready and committed to sign.

The client’s commitment to reform should not be confused with the client’s ability to convince key decision makers, including the regulator and the Ministry of Transport, of the need for reform. A signed loan agreement can be an effective vehicle to convince decision makers to move forward. It was recognised that the reform timetable was ambitious, but there is a question as to whether the reforms would have progressed as much as they did without an ambitious timetable and ongoing dialogue.

**Key Recommendations**

Management notes that while the Operation Evaluation concerns one operation, with respect to the proposed recommendations it refers to the other project restructuring loan. The attempt to create a nexus between the two operations could be practical if EvD covered all of the projects with the Client comprehensively. Otherwise, the attributes specific to each financing should be assessed separately. In this context and as guidelines for further actions:

- Management agrees with the recommendation that future Client project documents should contain more comprehensive information on progress of the railway sector reform [in which the Bank has played a key role].

- Further, Management is committed to monitor carefully future developments in corporate governance/anti-corruption measures. The project proposals for any repeat project with the Client group will be accompanied by an update and analysis of the implementation of the Code of Conduct and anti-corruption measures as recommended by EvD.

Management notes EvD’s recommendation referring to a possible future conversion of the outstanding loan into equity. As confirmed in the response to the relevant DAQs, it was always Management’s intention to proceed with any potential conversion of the restructuring loan on the basis of separate approvals by the Operations Committee and the Board.