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**PRE-FEASIBILITY STUDY FOR THE DEVELOPMENT OF A
REGIONAL EXISTING TRANSPORT EQUIPMENT PLANT**

ZECO - ZIMBABWE

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PROJECT N° DU/RAF/89/850

CONTRACT N° 93/026

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INVESTMENT PROPOSAL REPORT

1382

July 1993

SOFRECO

SOCIETE FRANCAISE DE REALISATION, D'ETUDES ET DE CONSEIL

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INTRODUCTION

INTRODUCTION

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The present study was carried out within the framework of UNTACDA's objective for the promotion of an African industry in the field of transport equipment. The project document was signed in April 1990.

The project consisted of two parts :

- Diagnostic survey for the selection of 4 pilot regional plants.

This survey was performed in the middle of 1991 and lead for the Southern Africa sub-region to the selection of the company ZECO in Zimbabwe.

- Prefeasibility study of the selected company, plus investment proposal report.

This study, regarding the company ZECO, was awarded by UNIDO to the French Consulting company SOFRECO in Paris through contract N° 93/026 of February 16, 1993, following the project N° DU/RAF/89/850.

The present report is the investment proposal report.

IMPORTANT NOTE

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The first diagnostic survey was performed in the middle of 1991.

Upon arriving at the site in May 1993, the SOFRECO's experts discovered that ZECO was already implementing a new expansion project with a value of about 5 million US\$, that is approximately 20 % of the company's turnover.

The project is the expansion of the rolling stock production capacity.

In May 1993, financing was approved with 50 % through shareholders' funds and 50 % through a commercial bank loan.

- the equipment was ordered,
- the civil works had begun, including increasing the length of the existing bays.

The beginning of operations with the new facilities is planned for the 4th quarter of the current year (1993).

Moreover, taking into account the present and future status of the accessible market for ZECO, it appears that the present expansion will allow ZECO to be well adapted to its market for several years.

Therefore, no other project could be suggested and studied.

Consequently, the present study is more a post justification of ZECO's expansion project than a real pre-feasibility study.

CHAPTER 1
BRIEF DESCRIPTION OF THE COMPANY

1.1. THE ENTERPRISE

ZECO is an important mechanical manufacturing company in Zimbabwe, located in Bulawayo.

It is a public company incorporated in Zimbabwe. The current manpower is about 1000 persons and the turnover in 1992/93 (fiscal year ending 28th of February) was approximately 100 million Zimbabwean dollars (equivalent to 16.7 million US\$).

ZECO was founded in 1948 by JOHNSTON and FLETCHER, another manufacturing company in Zimbabwe, which is still an important shareholder.

The main business of ZECO is distributed among 3 divisions :

- 1) manufacturing of railway rolling stock, steam, diesel electric and electric locomotive rehabilitation and assembly,
- 2) fabrication and structural engineering,
- 3) erection contracting.

The railway division contributes to about 50 % of the turnover.

In each division, the orders are subject to wide variations. However, the existence of three activities allows the company to regularize its annual turnover.

According to the loads, ZECO makes transfers of unskilled or semi-skilled personnel from one sector to another.

Futhermore, for erection contracting, it is possible to hire temporary manpower.

1.2. THE RAILWAY DIVISION

The rolling stock activity began in 1964. Up to 1985, ZECO's activity was oriented almost entirely towards the local market, particularly for National Railway of Zimbabwe (NRZ).

From 1986 to 1992, however, an average of over 90 % of the rolling stock was exported to other African countries, namely Botswana, Ethiopia, Tanzania (plus Tazara), Malawi, Mozambique, Madagascar, and Uganda.

In the regional market, the sales of ZECO are also made easier by the fact that NRZ track is laid to a 1 067 mm gauge, the standard gauge for Southern Africa, which is also used by the railways systems in Zambia, Zaire, Mozambique, Botswana, Angola, Swaziland, Tanzania/Zambia Railway Authority (TAZARA) and RSA in an inter-connected regional system.

CHAPTER 2

SPONSORSHIP AND MANAGEMENT

2.1. CAPITAL STRUCTURE

2.1.1. Capital stock and main shareholders

ZECO is a public company incorporated in Zimbabwe.

In 1992, the number of shareholders is 512, with the following distribution :

	Number of shareholders	%	Number of shares	%
ORDINARY SHARES				
Parent company	1	1	27 024 941	45
Nominee companies	11	2	4 820 676	8
Pension funds	13	3	3 483 810	6
Other residents	462	89	15 375 974	26
Non-residents	25	5	9 142 007	15
TOTAL	512	100	59 847 408	100

- 1) The parent company, owning 45 % of ZECO's capital, is MEIKLES Consolidated Holding. MEIKLES is a private company, a well-known Zimbabwean group family-owned and acting on stores, tea plantations, cattle farms and big hotels in Harare and Bulawayo.

Included in the 45 %, 20 % is held by the company JOHNSON and FLETCHER, incorporated in Zimbabwe.

JOHNSON and FLETCHER is an industrial company with a size comparable to ZECO (860 staff employed ; turnover 100 Million \$).

50 % of the ordinary shares are held by the same Holding company as ZECO.

- 2) Nominee companies hold 8 % of ZECO.
There are stockbrokers and other companies, such as investment companies.

- 3) Pension funds hold 6 % of ZECO.

The main funds are :

- OLD MUTUAL
- ZESA
- POLICE

4) Other residents hold 26 % of ZECO.

Their number is 462. Each of them has therefore a small participation.

5) Non residents hold 15 % of ZECO.

This include English citizens related to Barclays Bank, namely Mr R.C. BUXTON, and Mr H. YOUNG.

Of the nominee companies, 5 of them are also controlled by members of the MOXON family.

Consequently, MEIKLES Holding holds directly or indirectly more than 52 % of the capital. They therefore have completed control of ZECO.

2.1.2. Movements and values of shareholders funds

All monetary figures in \$ 000

	1987	1988	1989	1990	1991	1992
Shareholder's funds	8 885	9 076	10 611	24 873	54 908	64 096

An important increase in capital of approximatively 25 Million Zimbabwean \$ took place in January 1991. The shareholders' funds rose from 24 873 Million Zimbabwean \$ to 54 908 Million Zimbabwean \$.

The parent company undersigned the offer, commulting itself to buying all shares not sold to the public.

The new funding enabled the company :

- a) To finance expansion in the rolling stock and structural divisions.
- b) To expand the machine shop in order to be better placed for future export orders.
- c) To take advantage of opportunities that may materialise for joint ventures in allied heavy engineering fields.

Futhermore, the additional funding was expected to eliminate all medium term bank loans and improve the Company's cash flow.

2.2 GENERAL INDICATORS : BUSINESS OBJECTIVES AND CORPORATE STRATEGIES

2.2.1. Balance sheet at February 29, 1992

	1992 \$ 000
<u>CAPITAL EMPLOYED</u>	
Shareholders' Equity	
Share capital	29 924
Share premium	12 202
Non-distributed reserve	10 568
Retained income	11 402
TOTAL CAPITAL EMPLOYED	64 096
<u>EMPLOYMENT OF CAPITAL</u>	
Fixed assets	40 909
Investments	42
TOTAL	40 951
<u>CURRENT ASSETS</u>	
Inventories and contracts in progress	30 432
Debtors	54 293
Funds on deposit	428
Bank balances	6
TOTAL CURRENT ASSETS	85 159
<u>CURRENT LIABILITIES</u>	
Creditors	36 244
Short term borrowings	13 190
Bank overdraft	9 229
Dividends	3 351
TOTAL CURRENT LIABILITIES	62 014
NET CURRENT ASSETS	23 145
TOTAL EMPLOYMENT OF CAPITAL	64 096

2.2.2 Statement of value added

From an operation's point of view, the following table gives the main indicators.

	1991 \$000		1992 \$000		1993 \$000
Sales	74 623		61 447		101 374
Sales Tax	1 237		1 099		
	75 860	100 %	62 546	100 %	
Less : Cost of materials and services purchased	56 001	74 %	42 231	68 %	
Value added	19 859	26 %	20 315	32 %	
Value added per employee	18.9		26.2		
Distributed to :					
Employees					
Salaries, wages and benefits	13 356	67 %	9 457	47 %	
Government taxes	1 237	6 %	1 099	5 %	
Re-invested in the company	2 739	14 %	4 846	24 %	
Depreciation	767		1 499		
Retained profits	1 972		3 347		3 973
Providers of capital	2 527	13 %	4 913	24 %	
Dividend to shareholders	1 915		3 351		4 010
Interest paid	612		1 562		1 760
	19 859	100 %	20 315	100 %	

It can be seen that the ratio between value added and turnover is in the range of 30 %. This shows that the manpower factor is important in ZECO's business.

From the shareholders' point of view the main indicators are the following :

	1991	1992	1993
Turnover	74 623	61 447	101 374
Profit after taxation	3 887	6 698	7 983
Total assets	87 0741	126 110	
Shareholders' funds	54 908	64 096	
Return on shareholders' funds	10,4 %	10,5 %	
Earning per share - cents	9,5	11,2	13,3
Dividend per share - cents	4,7	5,6	6,7
Dividend cover - times	2	2	2

The main comments could be the following :

- 1) The return on shareholders' funds is in the range of 10 %.
- 2) The board maintains a ratio of two to one between earnings and dividends. This shows concern for giving a normal remuneration to the shareholders while keeping a significant part of the earnings in retained profits for the company.

2.3. ANALYSIS OF ZECO'S FINANCIAL EVOLUTION SINCE 1988 WITH THE METHOD OF RATIOS

NOTA

- 1) When the mission was in Zimbabwe in May 1993, only some figures (turnover-profit) of the fiscal year 1992/93 were known, because the fiscal year ends on February the 28th.

Therefore, the comparaisons are made from 1988 to 1992.

- 2) The important inflation in the recent period makes it difficult to compare the figures in normal values. However, it is possible to calculate ratios which allow to study the evolution out of the inflation factor.

2.3.1. Production ratio

$$\text{Ratio : } \frac{\text{Net income}}{\text{Turnover}}$$

This very important ratio allows to evaluate the performances of the enterprise in its competition environment.

The values are the following :

	1988	1989	1990	1991	1992	1993
Profit	597	1641	3137	3887	6698	7983
Turnover	21121	45117	62367	74623	61447	101374
Ratio	3 %	4 %	5 %	5 %	11 %	8 %

It can be seen that the ratio, which was about 5 % up to 1991, increased strongly to 11 % in 1992 and maintained a good level of 8 % in 1993.

The commercial performances of ZECO are therefore quite satisfactory.

2.3.2. Financial structure ratios

A)
$$\text{Ratio : } \frac{\text{Permanent funds}}{\text{Fixed assets}}$$

This ratio allows to compare the economic capital with the financial capital. It is very important, because it shows the available working capital.

It must be always higher than 1.

The values for ZECO are the following :

	1988	1989	1990	1991	1992
Permanent Funds	9 076	10 611	55 638	54 908	64 096
Fixed assets	7 221	8 116	22 811	33 407	40 951
Ratio	126 %	131 %	244 %	164 %	157 %

The above ratios, chiefly these of the recent years which are higher than 1.5, show that the enterprise beneficiates of a comfortable working capital.

B) **Ratio :** Shareholders' funds

Total liabilities

This ratio gives an indication on the financial independance of the company.

The values are the following :

	1988	1989	1990	1991	1992
Shareholder's funds	9 076	10 611	55 638	54 908	64 096
Total liabilities	19 195	51 244	48 688	87 071	126 110
Ratio	47 %	21 %	51 %	63 %	51 %

This ratio of roughly 50 % confirms the financial autonomy of the company.

2.3.3. Profitability ratio

Ratio : Net income

Shareholders' funds

The values for ZECO are the following :

	1988	1989	1990	1991	1992
Profit	597	1 641	3 137	3 887	6 698
Shareholder's funds	9 076	10 611	55 638	54 908	64 096
Ratio	7 %	15 %	13 %	7 %	10 %

From the shareholders point of vue the profitability of the enterprise is good. The decrease in 1991 corresponds to the increase of capital.

To summarize, ZECO is a very sound company, both on the industrial and financial point of vue.

CHAPTER 3
MARKETS AND SALES

3.1. MARKETING ORIENTATION

In Zimbabwe, the main customer is of course National Railways of Zimbabwe (NRZ).

Within the framework of its restructuring program, implemented with the help of the World Bank, NRZ will invest in the following components :

- procurement of 25 new main line locomotives.
- repowering of 43 shunting locomotives.
- provision of locomotive spare parts.
- procurement of about 520 dropsided and about 500 high-sided wagons.
- procurement of 50 passenger coaches.
- rehabilitation of coaches.

The programme is to be implemented over a six-year period.

ZECO could of course participate in the repowering of the shunting locomotives, the complete fabrication of the wagons, and the rehabilitation of the coaches.

In the sub-region, the situation is difficult. None of the national railways companies is commercially viable.

In Zambia, with efficient operation and reasonable utilisation levels, Zambia Railways (ZR) requires no additional locomotives or rolling stock.

In Tanzania, in the market accessible to ZECO, there will be a rehabilitation of 27 coaches over two years.

In Malawi, the new investments in rolling stock are very small and efforts are mainly oriented towards the improvement of tracks.

In Mozambique, due to the 17-year civil war, the reopening of routes is slow and current main efforts of the Mozambique Ports and Railways (CFM) are oriented to the rehabilitation of tracks.

In Botswana, the situation is better, but the activity of the national railway company is small.

In short, the expected orders to ZECO from the sub-region are very small in the short and medium term.

Fortunately, thanks to credits allowed mainly by Japan, the situation is better in other African countries in the accessible market for ZECO.

Moreover, ZECO will probably get an important order in Malaysia.

To summarize, the present sales forecast of ZECO, in the short term, is the following :

- Wagons

CLIENT	QUANTITY	YEARLY AVERAGE
NRZ	400 4 years	100
MALAYSIA	500 2 years	250
GHANA	100 1 year	100
UGANDA	100 1 year	100
SUDAN	100 1 year	100
BURKINA FASO	50 1 year	50
ETHIOPIA	100 2 years	50
TOTAL	1 350	750

ZECO considers that the probability for getting the orders is 50 % of the total. The annual amount of orders in the short term is therefore 375 wagons per year, for a present capacity of 200 wagons per year.

This shows the urgent need for an expansion of the rolling stock production facilities.

Additional orders in production or rehabilitation of coaches could be the following:

CLIENT	QUANTITY	YEARLY AVERAGE
TANZANIA RAILWAY	27 2 years	14
NRZ	55 2 years	27
TOTAL	82	41

Using the same probability coefficient of 50 %. ZECO could therefore get orders for the construction of 20 coaches per year.

To this must be added a rehabilitation of 100 coaches in 2 years again in Tanzania, although in this particular case, TANZANIA RAILWAYS would themselves do the rehabilitation and ZECO would supply the components : windows, seats, water Tanks, etc.

- Locomotives

In 1970, ZECO ventured into the locomotive field. Since then, the following projects have been undertaken :

- 85 Alstom diesel locomotives rebuilt structurally, with National Railway of Zimbabwe providing power units.
- 24 locomotives rebuilt and repowered with Brush U.K.
- Rebuilt complete 2 GE locomotives for Mozambique. This included engine and traction motor overhaul and rebuild.
- 3 GM Henschel Locomotives for Ziscosteel, complete rebuild and overhaul of engine.
- Manufacture and assembly of 30 all-electric locomotives with ABB.
- **ZECO could therefore participate in the NRZ programme.**

3.2. PRESENT AND POTENTIAL COMPETITION

The main competitors of ZECO are the following :

On the local market, one company only, MOREWEAR, located in Harare.

On the international market, numerous and very active companies, principally :

- Daewoo (South Korea),
- PEC (Projects and Equipment Cy) (India),
- SEMAF (Egypt),
- Cobrasma (Brasil),
- TAFESA (Spain).

3.3. DUTIES AND TAXES - TARIFF PROTECTION

3.3.1. Sales tax

This is levied on the purchase of most goods and services within Zimbabwe. The basic rate is 10 per cent. For semi-durable goods, the rate is 15 %, but a higher rate of 20 per cent applies in the case of durable goods (and many other items which may be considered luxuries). As an incentive for investment in high priority projects and/or investment in designated "growth point areas", Government has provided for the refund of Sales Tax on goods of a capital nature purchased within Zimbabwe.

With respect to sales tax, as to the Import tax, a recent concession announced by Government provides for the refund on the importation of new goods of a capital nature (i.e. plant and equipment) earmarked for approved new projects which are : Priority projects, i.e. they involve exports or create an appreciable number of job opportunities or introduce new technology ; and/or of any type, but located in a designated "growth point area".

3.3.2. Duties and taxes on imported items

Customs Duty, Sur-tax and Import Tax are levied on various items imported into Zimbabwe. However, the rates on items of primary interest to potential investors are very modest and are in line with corresponding rates levied by developed countries. Furthermore, Government offers a number of specific incentives to new investment through the rebate or drawback of various import duties and taxes, and these result in an effective rate of zero. The following paragraphs give an outline of the main provisions.

Customs Duties range from 0 per cent up to 50 per cent (for cars), with most items of interest to investors being in the range 5-20 per cent. Surtax is normally 20 per cent but some industrial, agricultural and mining equipment qualifies for a 15 per cent rate. Rates of Import Tax range from 10, 15 and 20 per cent.

With respect to Customs Duty as an incentive to the manufacturing industry, many raw materials and components are either imported duty free or at rebate rates of duty. Similarly, as an incentive to the export sector, a system of industrial drawbacks allows full remission of duty on those imported raw materials and components contained in exported goods. Duty free import (or duty rebate) of some plant and equipment is also possible.

3.3.3. The Preferential Trade Area

The Treaty for the establishment of the Preferential Trade Area for Eastern and Southern Africa States was concluded at LUSAKA on the 21st December, 1981 and entered into force on the 30th September, 1982.

Currently, PTA includes the following countries :

COUNTRIES	CURRENCY
ANGOLA	Kwanza
BURUNDI	Franc
COMOROS	Franc
DJIBOUTI	Franc
ETHIOPIA	Birr
KENYA	Shilling
LESOTHO	Maloti
MALAWI	Kwancha
MAURITIUS	Rupee
MOZAMBIQUE	Metical
RWANDA	Franc
SOMALIA	Shilling
SUDAN	Dinar
SWAZILAND	Lilangeni
TANZANIA	Shilling
UGANDA	Shilling
ZAMBIA	Kwancha
ZIMBABWE	Dollar

The main objective of the Agreement between the members of PTA is to encourage trade between the states.

The Agreement also aimed at strengthening regional economic co-operation and the integration of development efforts by member states.

The main thrust of PTA is the promotion of trade in goods and services as a means toward achieving the broader goals of accelerated development, transformation and industrialisation in the sub-region.

The Unit of Account of the PTA (UAPTA) is equal to the Special Drawing Right (SDR) of the International Monetary Fund and all intra-regional settlements are expressed and recorded in this unit of account.

In Zimbabwe, the Government published at the beginning of 1993 (Statutory Instrument 3 of 1993) a schedule giving the new values of customs duties and surtax applying to a considerable number of products.

The new tariffs are applicable only if the goods concerned are produced or manufactured within the territory of any one of the Member States and comply with the rules of origin set in the P.T.A. Treaty.

The products are classified according to the Harmonized System (H.S. Code). The Harmonized System Code sections corresponding to railway materials (locomotives, wagons, coaches, parts) are numbers 8 602 to 8 609 (four first digits), inclusive.

It can be seen in the schedule (page 95) that, for these goods :

- Effective customs duty is free.
- Effective surtax is either 3,24 % or 4,32 %.

These figures are therefore very low.

CHAPTER 4

DESCRIPTION OF THE EXPANSION PROJECT

4.1. GENERAL

The sales forecast for ZECO shows that the company has to increase its wagon production capacity from 200 units (current production) to 375 units.

Moreover, the company has to improve its capacity for rehabilitation and construction of coaches.

An expansion project is therefore planned, with the following main features :

4.2. LOCATION, SITE AND ENVIRONMENT

In order to implement the expansion of rolling stock capacity, ZECO has acquired approximately 6 500 m² of land, adjacent to the London Road plant works .

On this new property, the company plans to build new buildings to increase the length of the existing bays. The additional covered area would be 3 700 m², an increase of 31 % of the workshop's size.

Since it is therefore an expansion, the new project will benefit from the existing facilities in utilities, electricity, water, of the present works.

4.3. TECHNOLOGY

Additional equipment can be divided into two categories :

- complementary machines of existing types (but probably with some improved performance due to up-to-date technological progress) such as lathe, drill, press, fork lifts, plate rolls, shot blasting machine, saws, etc ...
- new facilities allowing more integrated production (providing more value added) such as fiber glass moulding shop for seat manufacturing (until now, seats have been purchased from suppliers for previous coach refurbishing).

4.4. INVESTMENTS AND ADDITIONAL SALES

Financial statements for the new expansion projet are the following, in million US\$ or Z\$(\$):

Fixed investment

Foreign currency	2,55 MUS\$ or 16,32 M\$
Local currency	17,28 M\$
Interest during construction	0,83 M\$
TOTAL	34,43 M\$

Additional sales

Taking into account only the rolling stock increase in wagons with a price per unit of 55 000 US\$, the additional sales are the following :

Foreign currency	80 %	7,7 MUS\$ or 48,28 M\$
Local currency		13,32 M\$
TOTAL		61,600 M\$

Sales correspond to approximately twice the value of the investment.

This is characteristic of a "light industry", but we must keep in mind that this new investment benefits from existing facilities.

4.5. PRODUCTION COSTS

The respective weights of the components are the following :

	M\$	
- raw materials	18.64	39 %
- labour, direct	12.3	26 %
- overhead and administrative costs	10.11	22 %
- other production costs	2.6	6 %
- depreciation	2.37	5 %
- financial costs	0.83	2 %

4.6. RAW MATERIALS

Raw materials employed are composed mainly of steel or aluminium plates and sheets. The plates are used for building underframes or chassis of rolling stock and also special tanks (for high pressures). The sheets are used for building tanks and panels or doors of wagons and coaches. Aluminium is used as often as possible in order to reduce weight, thereby improving the load capacity. Sectional steels are either purchased or made in the company workshops according to their size, dimension or shape.

Other components such as bearings, axles, wheels, couplings, braking systems, welding rods, paint, electric wires, etc. are supplied by local or foreign factories. Bearings and couplings are imported from specialized foreign companies, as is the case for most braking systems components. Axles machining is carried out in ZECO plants with special imported steel.

Approximately, 30 % of the value of raw materials are imported and 70 % are supplied locally.

4.7. HUMAN RESOURCES - ADMINISTRATION AND OVERHEAD COSTS

The expansion will lead to the creation of roughly 150 additional jobs.

ZECO has some problems finding locally skilled manpower.

Administration and overhead costs are in fact the additional commercial costs resulting from development of sales in other African countries or overseas (Malaysia).

4.8. PLANT IMPLEMENTATION

The delivery time is less than one year.

Of course, ZECO's structural and erection divisions will participate in a large part of the civil engineering works and the estimated budget could be reduced.

Excavating work is being done. Workshop erection and equipment mounting will be achieved by the end of this year. Final machine layout will be optimized taking into account materials flows in connection with production lines.

CHAPTER 5
FINANCING AND RETURN

5.1. FINANCING

Source of finance

A - FOREIGN

For the initial investment in foreign currency, a private bank loan of 2.6 M\$ could be arranged.

ZECO believes that the company would not have any problem obtaining such a loan.

The conditions would be approximately the following :

maturity	8 years
interest rate	10 %

B - LOCAL

The initial investment in local currency of 17.28 M\$ would be entirely covered with funds from the shareholders, through an increase of capital, if necessary.

5.2. FINANCIAL ANALYSIS - RETURN

Taking into account the investment cost, source of finance, production costs, depreciation rates, etc, the financial results obtained through the COMFAR are the following :

1. Internal rate of return

A. The Internal Rate of Return on total investment (IRR) is equal to 35 %.

This figure, when compared with an average level of 20 % for interest rates in Zimbabwe, shows a good profitability for the project.

B. The Return on Equity (IRRE 1) is equal to 61 %.

This criteria is in relation with the possibility of attributing dividends to shareholders, which is obvious in this project.

2. Pay back period

The pay back period is 3 years, which is quite satisfactory.

3. Debt service ratio

This ratio is always higher than 1. There is therefore no cash problem.

4. Break-even point

Including financial costs, the break-even point is equal to 45 %.
This good ratio shows a good security in regard to sales variations.

To summary, the financial profitability of this project is excellent.

Variant with inflation

We proceeded to COMFAR calculations with an inflation rate of 10 %.

The IRR is then 41 %

The IRRE 1 is 72 %

Conclusion

In conclusion, the expansion project is excellent for ZECO.

This expansion has been made possible by the considerable efforts made by the company to increase its sales, particularly on the export market.

Main COMFAR schedules and charts are placed in the following pages.

ZIMBABWE ZESCO EXTENSION DE L'USINE
 01/06/1993 ZDC6A1
 PRODUCTION DE WAGONS

1 year(s) of construction, 15 years of production
 currency conversion rates:

foreign currency 1 unit = 6.4000 units accounting currency
 local currency 1 unit = 1.0000 units accounting currency
 accounting currency: MILLIONS DE \$ ZIMBABWE 1USS=6.45

Total initial investment during construction phase

fixed assets:	34.43	49.814 % foreign
current assets:	0.00	0.000 % foreign
total assets:	34.43	49.814 % foreign

Source of funds during construction phase

equity & grants:	18.00	0.000 % foreign
foreign loans :	16.64	
local loans :	0.00	
total funds :	34.64	48.837 % foreign

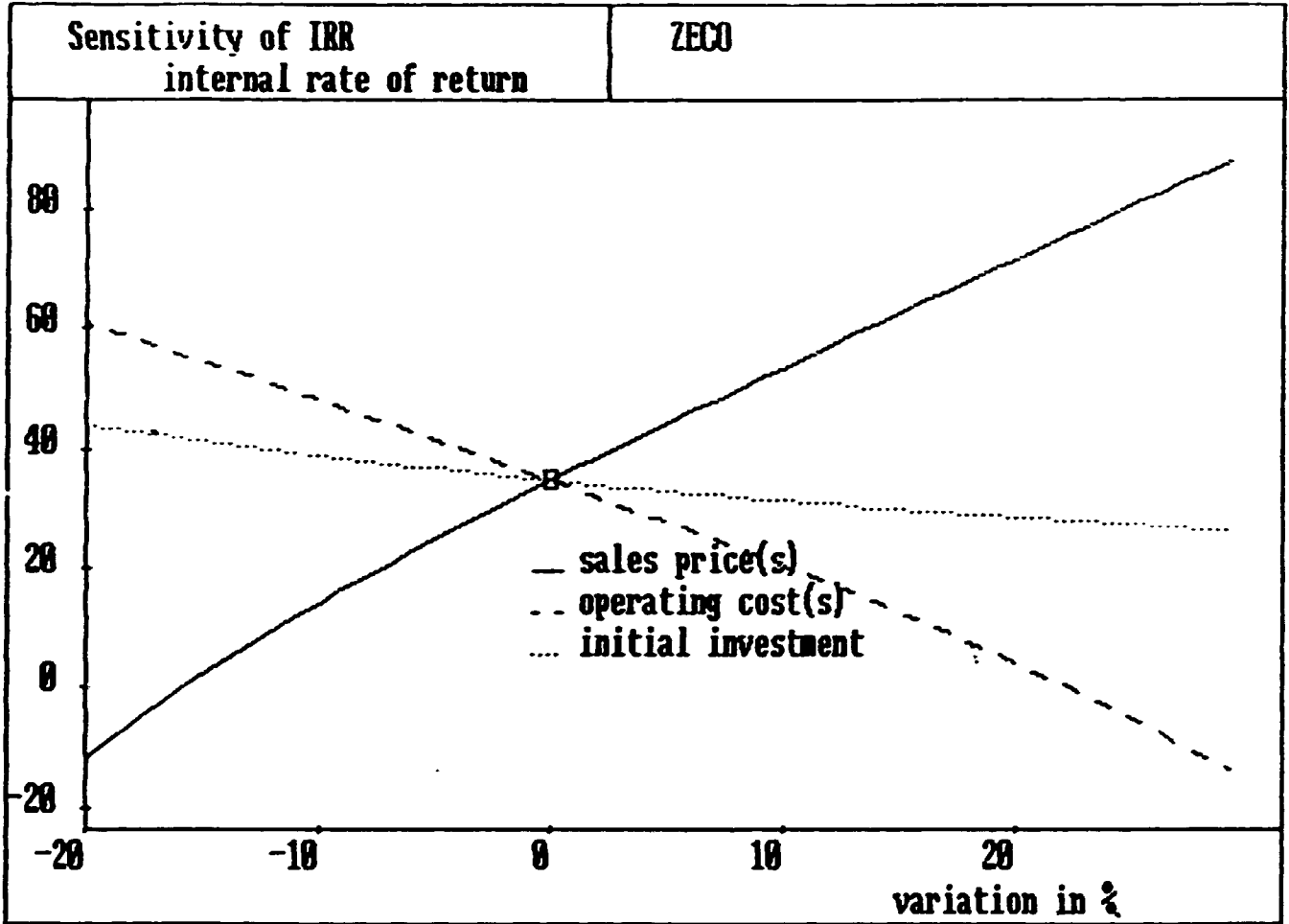
Cashflow from operations

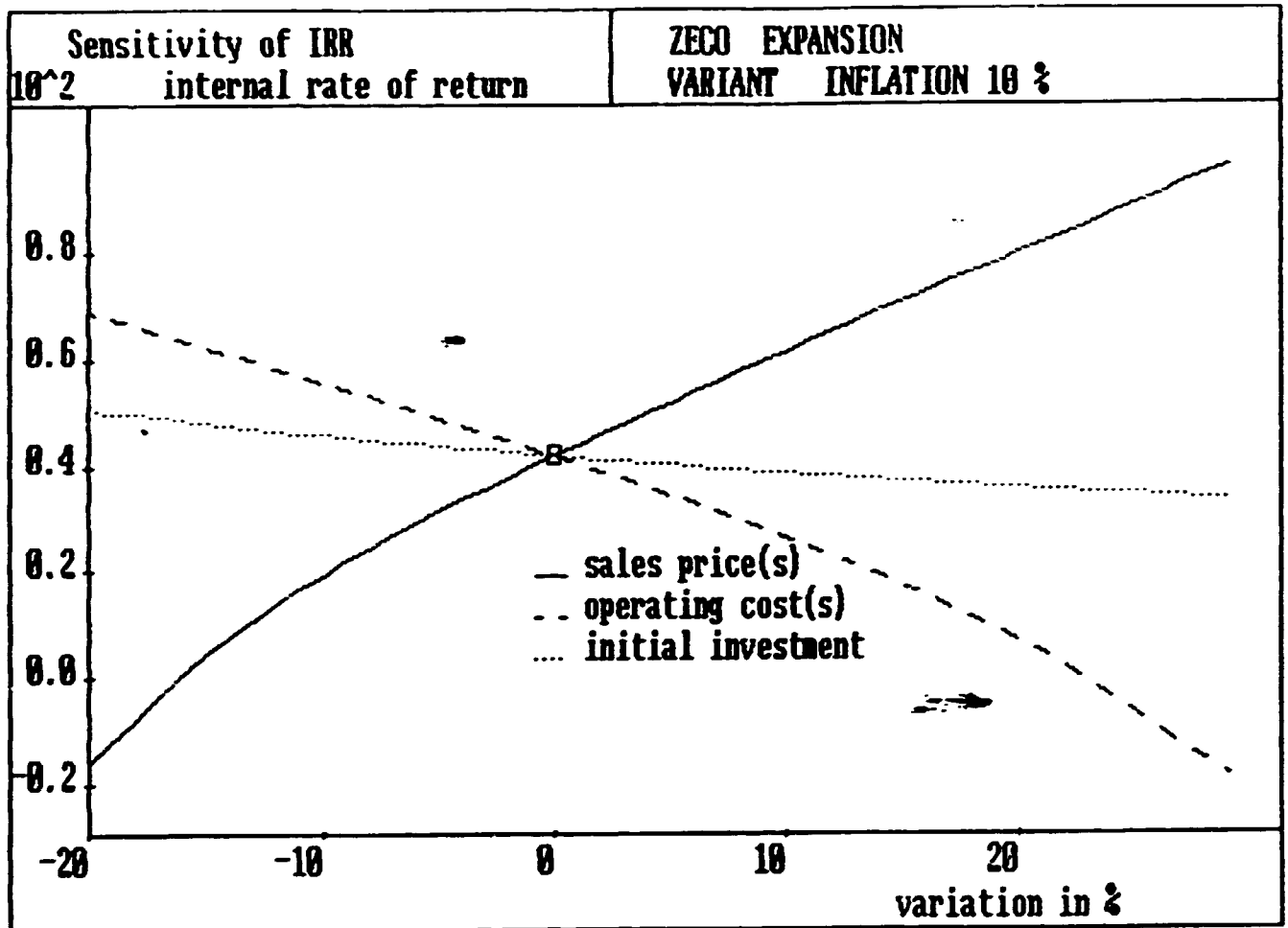
Year:	1	5	10
operating costs:	43.69	43.69	43.69
depreciation :	3.32	2.36	1.21
interest :	1.66	0.83	0.00
production costs	48.67	46.88	44.89
thereof foreign	16.49 %	14.16 %	10.35 %
total sales :	61.60	61.60	61.60
gross income :	12.93	14.72	16.71
net income :	12.93	8.09	9.19
cash balance :	4.74	6.78	8.79
net cashflow :	8.49	9.69	8.79

Net Present Value at: 20.00 % = 21.11
 Internal Rate of Return: 34.68 %
 Return on equity1: 60.91 %
 Return on equity2: 47.53 %

Index of Schedules produced by COMPAR

Total initial investment	Cashflow Tables
Total investment during production	Projected Balance
Total production costs	Net Income Statement
Working Capital requirements	Source of Finance





CHAPTER 6
GOVERNMENT SUPPORT AND REGULATIONS

6.1. THE ECONOMIC REFORM PROGRAMME

In Zimbabwe, the general outline of the Government's action is the Second Five-year National Development Plan 1991-1995.

In this plan, in the field of economy, the Government began at the end of 1990 the implementation of the Economic Reform Programme, with three main objectives :

- trade liberalisation
- removal of price controls
- relaxation of labour regulations.

The reforms aim to create an environment which will stimulate investment and growth. The implementation of the Economic Reform Programme was pursued in 1991 and 1992, despite the difficulties resulting from the drought.

Regarding the manufacturing sector in general and ZECO in particular, the main points are the following :

6.2. TRADE LIBERALISATION, OGIL and ERS

Trade liberalisation is made through a two pronged strategy, that is placing items on to the Open General Import Licence (OGIL) and enhancing the Export Retention Scheme.

The Export Retention Scheme is a mechanism through which an exporter may keep a percentage of the foreign currency resulting from its foreign sales. The E.R.S. funds may be used to freely import goods. The goods imported are freely transferable.

If the exporter does not use the totality of the E.R.S. for his own imports, he can sell the difference.

The unrestricted OGIL was increased to 20 percent of imports while the restricted, or end user specific OGIL is in 1993 at 13 percent.

Since its inception in 1989, the Export Retention Scheme (ERS) has increased over time from the original 5 and 7.5 percent, and stands in 1993 at 35 percent of export earnings.

The Government took the decision to pursue trade liberalisation primarily through the ERS route.

It is important to pursue this strategy, which is linked to increased exports, in order to generate the foreign exchange earnings required for the economic reform programme to be successful.

To support more rapid export growth, the ERS was enhanced to 15 percent during the second half of 1991. From January to June 1992 the ERS was raised from 15 percent to 25 percent. The level was raised from 30 percent in the last half of 1992 to the current level of 35 percent.

6.3. EXPORT INCENTIVE SCHEME (E.I.S)

The Export Incentive Scheme is a mechanism through which a tax free cash payment may be made to registered Zimbabwean exporters on the basis of actual performance and of a list of qualifying export commodities.

The current rate is 9 % of the FOB value of the exports.

6.4. FISCAL INCENTIVES

There are a number of provisions within the fiscal system, which are aimed at promoting exports and investment. These include the duty drawback system, the inward processing arrangement, and the duty exemptions on capital goods, in addition to the current 9 percent incentive scheme.

6.5. DUTY EXEMPTIONS FOR CAPITAL GOODS

At the beginning of 1992, exemptions were introduced for capital goods from import tax and surtax for imports under ZIC-approved projects. Investments made outside ZIC can benefit from this facility if they apply for exemption through ZIC. The approval process which caused delays in obtaining Exemption Certificates was simplified by delegating the authority to the Department of Taxes who determine whether the goods in question are of a capital nature.

A list of qualifying capital goods will be produced thereby obviating the need for application to get an exemption. The exemption of capital goods from import tax and surtax means that the only import duty paid in respect of capital goods is the customs duty.

6.6. INVESTMENT INCENTIVES

In spite of the balance of payments constraints which still necessitated some exchange controls, the Government recognised that the remittability of dividends and profits was an important consideration for foreign investors. In order to provide a clear signal to foreign investors and to promote rapid investment in Zimbabwe, the following new reforms on dividends and capital remittances will apply :

Effective May 1 1993, any new company established with foreign shareholding and without recourse to direct foreign exchange allocation is automatically eligible for unrestricted remittance of after-tax dividends accruing to the foreign shareholders, provided those dividends are paid in foreign exchange through the ERS market.

CHAPTER 7
CONCLUSION

From a technical point of view, ZECO's primary market is in wagon construction and the rehabilitation of coaches and steam locomotives.

With the technical expertise which ZECO intends to acquire this technology could easily be transferred to the complete construction of coaches.

However, the fabrication series are small (300/400 wagons of various types per year). This does not justify the large degree of automatization that would be necessary to produce higher-technology items. Moreover, the market for locomotives is very limited.

In fact, ZECO is well adapted to its market and it would be hazardous for the company to proceed with a large investment for more sophisticated products.

From a commercial point of view, ZECO was clever enough to release itself from the economic stagnation of the subregion and of PTA countries in general. Thanks to, in particular, the dynamism of its Managing Director, ZECO was able to obtain contracts in other countries, thus allowing it to double its sales in wagons and to proceed with an expansion of the rolling stock facilities, through the project described in this study. The new equipment will be in operation before the end of the current year (1993). Moreover, the NRZ's restructuring programme will allow ZECO, in the coming years, to maintain its current workload even if all other projected export sales did not materialize.

From a financial point of view, as can also be seen in various production, financial structure and profitability ratios, ZECO is a sound and well-managed company.

ZECO gives its shareholders a good return. However, these shareholders are concerned with :

- permanently promoting the development of their company, at the same time retaining for the company an equal amount of funds as for dividends,
- keeping complete financial independence. The increase in capital in 1991 was done partly to eliminate all medium-term bank loans.

The new investment will increase ZECO's profitability. It must be emphasized, however, that this expansion results from the company's commercial efforts.

From a point of view of regulations, the Government's action largely contributes to the promotion of investments and development of export (OGIL, ERS, EIS, fiscal incentives). With its sales mainly oriented towards the export market, ZECO benefits fully from these regulations.

However, the general economic situation is not good in Zimbabwe, and is poor in the sub-region.

On the other hand, as noted in this study, the present investment will enable ZECO to be well-adapted to its market for several years.

There is therefore no financing opportunity in the medium term.

We hope, however, that the present study will contribute to making easier any future analysis for a new investment on the part of ZECO.