Exacutive summary amtrak

In 1970, the U. S congress founded the National Railroad Passenger Corporation (Amtrak) to provide efficient rail service. Amtrak is the primary provider of passenger-rail service in the United States, operating 516 stations in 44 states. Amtrak received federal funds to be used for their operating expenses. In the late 1990s, the National Railroad passenger Corporation (Amtrak) faced difficulties in being self-sufficient; as a result, the U. S Congress cancelled their federal funds by 2002.

For this reason, in April 1999, Amtrak came up with a new plan called, the " Acela" line, which will have high speed and high efficiency in Northeast Corridor. Amtrak is considering to purchase 15 high-speed locomotives and 20 train sets to meet the congressional goal of operating self-sufficiency by 2002. This project will cost 750 million, however, Arlene Friner, CFO of Amtrak, had already financed part of the equipment except six locomotives and seven train sets which will cost 267. million. Friner has three financial options to analyze and decide: borrowing, leverage-leasing, or the federal funds. She needs to choose the one that will be the most beneficial and cheapest for Amtrak. The last option is already dismissed for qualitative reasons, so now she only can consider the first two. Friner will find out the best option by calculating the DCF models of both the borrow-and buy option and the leverage-lease option considering that Amtrak will be unprofitable.

Discussion

Amtrak has been offered a good interest rate to finance the six locomotives and seven trains sets with a 20 years term at 6. 75% per annum with semiannual payments of $12. 303 million. Considering that Amtrak is going to be unprofitable, the corporate tax rate will be calculated as zero percentage. The useful life of the equipment is 25 years and residual value is 15% of the cost. After getting the results of DFC model of both the leverage-lease and the debt financing, it is easy to define that both options have advantages and disadvantage.

The leverage-lease cost of debt is 220. 26M, and the debt financing is 260. 26M; therefore the leverage- lease is better. The disadvantage is that the equipment is a lease, and Amtrak sooner or later will have to return it, instead keep it. The advantage of debt is that Amtrak can keep equipment after the debt has been paid. Obtaining a lease creates value by adding convenience of not having to do maintenance in-house and saves time and resources for concentration on other things.

Debt financing will creates pressure on Amtrak for greater cash flow to over increased interest expense that might need to be covered by selling assets short of cost. Recommendation Based on the results getting from the CDF models of leverage-lease and debt financing assuming Amtrak unprofitability, the leverage-lease is the best option to go with because this option will allow the company to get 40 million buyout for the equipment at the end of the lease term. It will be the option that will provide less cost and more beneficial to Amtrak.