
Brexit express can't take steam out of Europe's U.K. rail grab

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The U.K. may be clattering toward an exit from the European Union, but **its railways are headed full pelt in the opposite direction.**

As Brexit talks continue, the national rail companies of France, Germany, Italy and the Netherlands are snapping up contracts spanning London commuter routes to long-distance expresses as private British firms struggle to compete with the lower cost of capital available to their state-owned rivals.

Two decades after the world's oldest railroad was privatized, 14 of 19 major U.K. franchises are at least partly controlled by government-owned operators from mainland Europe. Even as the split from the EU looms, Rome-based Trenitalia SpA is planning the biggest raid yet with a bid to run the 55 billion-pound (\$71 billion) High Speed 2 line between London and northern England.

Overseas operators are amping up efforts to grab a bigger slice of the world's biggest open rail market as steps toward liberalization elsewhere proceed more slowly than expected. With **U.K. passenger journeys doubling to 1.7 billion** since privatization and ticket prices set to rise the most in five years in 2018 because of a peg to inflation, European state players are being joined by Japanese and Chinese companies eager for a slice of the franchise pie.

Foreign control of the rail network is an emotive subject in Britain, where trains have played a key role in the economy since horses pulled the first carriages back in the early 1800s. During the industrial revolution, steam locomotives delivered raw materials to mills and factories and shuttled goods throughout the country and for export around the world. The system was privatized in the 1990s as one of the last major selloffs of state assets begun by the Conservative administration of Margaret Thatcher.

'Priced Out'

Go-Ahead Group Plc, Britain's biggest rail operator, says it **doesn't expect Brexit to stymie the overseas challenge**, and that while competition is welcome, the government must ensure awards aren't distorted by foreign firms making low-ball bids

to gain a foothold in the U.K. The company was this month ousted from a contract to run trains in Birmingham, England's second-biggest city, by the Abellio arm of state-owned Nederlandse Spoorwegen.

"If the government wants me to export abroad we need work in the U.K.," Go-Ahead Chief Executive Officer David Brown said in an interview. "If I'm priced out, then we won't be exporting. We are not going to bid for things that are unsustainable. Sometimes a foreign operator may have different criteria."

Since last year's Brexit vote, state-controlled Deutsche Bahn AG's Arriva unit has won a two-year extension to its CrossCountry franchise stretching 775 miles from Cornwall to Scotland, taken over the London Overground network, and been confirmed as operator of the Northern regional concession.



Over the same period, in addition to its Birmingham win, Abellio has been awarded the Greater Anglia franchise for a further nine years, edging out Aberdeen-based FirstGroup Plc and London-based National Express Group Plc. And Trenitalia in January agreed to buy National Express's contract to run the C2C line between the capital and satellite towns to the east, signaling the exit from U.K. rail of a company once ranked as its biggest player.

Cheaper Financing

For Arriva -bought by Deutsche Bahn for 1.6 billion pounds in 2010 in the German

giant's first move into U.K. rail—there's no question that being part of Europe's biggest railway company confers an advantage in raising cash.

“We benefit so much from German ownership – from the treasury of Deutsche Bahn,” CEO Manfred Rudhart said in an interview. “We have access to financing streams that we never had as a listed company. That is a massive benefit in terms of our ability to invest in U.K. projects.” Rudhart has told DB that **Brexit shouldn't impact U.K. business fundamentally.**

The lower capital costs conferred by state ownership have become critical as the government seeks to wring more revenue out of rail infrastructure, causing margins on U.K. franchises shrink to around 3 percent from 10 percent when the network was first privatized. That trend has rendered U.K. rail unattractive, National Express said after selling its C2C contract, predicting that a slowdown U.K. passenger growth will “present significant challenges” to other operators.

HS2 Face-Off

European companies also have an advantage because they're vertically integrated, meaning that they have experience of running infrastructure projects, not just train operations, according to Mark McVicar, an analyst at Barclays in London. That's becoming more important as the government looks to reduce the role of state-backed track and stations manager Network Rail.

The extent of foreign penetration of U.K. rail was revealed by the list of competitors for the HS2 line in June. Trenitalia, partnered with FirstGroup, will draw on its experience with Italy's Red Arrow expresses in bidding for a route on which trains could reach 225 miles per hour. That's compelled Richard Branson's Virgin Trains and ally Stagecoach Plc, operator of the predecessor franchise, to team up with French leviathan SNCF, which operates the TGV service. Completing the lineup is an all-Chinese venture of Hong Kong's and MTR Corp. and Guangshen Railway Co.

U.K. companies say their chief concern is a lack of reciprocity, especially given EU rules requiring member countries to move toward liberalization. Go-Ahead, though a long-time partner of SNCF, is unable to compete in many mainland nations, according to Brown, who says foreign operators are honing their skills in Britain so that **they can be better prepared to protect their position at home once more markets are pried open.**

Even Deutsche Bahn admits to frustration at the pace of change given that Germany, too, is beginning to invite foreign tenders. “If someone comes into our travel market it's not unreasonable to ask that their market is opened up as well,” Rudhart said.

Meanwhile, there are some in Britain who say **Brexit should be used as a trigger to turn back the clock on privatization and re-nationalize the network**

. Unions in particular argue that if the railway is returning to state control, the state in question should at least be the U.K.

“Even from the early days foreign governments have tried to get their snout in the trough,” said Mick Whelan, general secretary of train drivers’ union Aslef. “We shouldn’t let them keep it there.”

(By Christopher Jasper, Bloomberg)